

RES JUDICATA AND COLLATERAL ESTOPPEL IN BANKRUPTCY

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WITHIN the context of bankruptcy and reorganization, the problems of res judicata and collateral estoppel involve the effect of judgments rendered by a bankruptcy court, and the effect in bankruptcy proceedings of judgments rendered by other courts.

Under the Bankruptcy Act, filing a bankruptcy (including a reorganization or arrangement) petition institutes an in rem proceeding of an equitable nature in federal court.¹ A lengthy interval often separates such institution of bankruptcy proceedings from the time when the estate is closed and the fiduciary (usually the trustee) is discharged. During this interval, many administrative steps may be taken, numerous lawsuits may occur, and judgments may be rendered.² Some of this litigation will take place outside the bankruptcy court proceeding, some within. For example, the United States may begin criminal proceedings outside the bankruptcy court against the bankrupt or another for the commission of a bankruptcy offense. Or a plenary action, involving the trustee or other representative of the estate and third parties, may be brought as an ordinary civil action, either in a federal district court or in a state court.³ And the trustee may of course intervene in a civil action pending in a federal or state court.⁴

Examples of bankruptcy court rulings which may have subsequent res judicata or collateral estoppel effect are orders adjudging or refusing to adjudge a debtor a bankrupt, granting or denying a discharge, allowing or disallowing a claim, granting or denying a turnover order, enjoining a creditor from proceeding with his nonbankruptcy action, selling property free and clear of encumbrances and determining distributive rights to the proceeds, barring claimants from property subject to the bankruptcy or reorganization court's jurisdiction, determining priorities, and confirming compositions, arrange-

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1. *Isaacs v. Hobbs Tie & Timber Co.*, 282 U.S. 734 (1931); *Gratiot County State Bank v. Johnson*, 249 U.S. 246 (1919); 1 COLLIER ¶ 2.09 (14th ed. 1940) [hereinafter cited as COLLIER]; 6 *id.* ¶ 3.05; see 5 MOORE, *FEDERAL PRACTICE* ¶ 38.30 (2d ed. 1951).

2. See *ibid.*

3. *Ibid.*

4. Bankruptcy Act § 11b, 30 Stat. 549 (1898), as amended, 11 U.S.C. § 29(b) (1952).

ments or reorganization plans. Many of these adjudications, such as that declaring the debtor a bankrupt or the decree confirming a composition, arrangement or reorganization plan, are plainly in rem in character. Some, on the other hand, are in personam—like the turnover order, which is in the nature of a mandatory injunction, and the allowance or disallowance of a claim. Moreover, although a particular proceeding may be in the nature of an action in rem, a relevant determination made in connection with the adjudication may have in personam effect with respect to a party over whom the court has in personam jurisdiction.⁵

As a general proposition, the ordinary principles of res judicata, collateral estoppel, and related doctrines determine both the effect that will be given bankruptcy decrees in bankruptcy and nonbankruptcy forums, and the effect of judgments and decrees of nonbankruptcy tribunals in the bankruptcy court. Thus, the same principles of double jeopardy, res judicata and collateral estoppel which are ordinarily applicable to federal criminal proceedings will govern the criminal prosecution of a bankruptcy offense and any judgment rendered therein.⁶ Similarly, since a plenary action is an ordinary civil action, the principles of judicial finality normally applicable to civil actions determine the res judicata or collateral estoppel effect of a judgment rendered in a plenary action brought by or against the trustee, or of a judgment rendered in a civil action in which the trustee has been properly made a party through substitution, addition or intervention.⁷ The effect of such a judgment therefore depends, as in other civil litigation, upon a determination of what was or should have been adjudged, since the judgment is res judicata only as to these issues.⁸ And, under principles of collateral estoppel, relevant and material issues, once adjudicated, are judicially concluded as between the parties and their privies

5. See, e.g., *Gratiot County State Bank v. Johnson*, 249 U.S. 246 (1919), discussed in text at note 62 *infra*.

6. For discussion of these principles, see *United States v. Williams*, 341 U.S. 58 (1951); *Sealfon v. United States*, 332 U.S. 575 (1948); *United States v. Oppenheimer*, 242 U.S. 85 (1916); *Harris v. State*, 193 Ga. 109, 17 S.E.2d 573 (1941); Lugar, *Criminal Law, Double Jeopardy and Res Judicata*, 39 IOWA L. REV. 317 (1954).

7. *Heiser v. Woodruff*, 327 U.S. 726 (1946), discussed in text at notes 216-26 *infra*; *Fischer v. Pauline Oil & Gas Co.*, 309 U.S. 294 (1940), 53 HARV. L. REV. 1043 (state court judgment in an action in which the trustee had intervened, which held that the lien of an execution was not avoided by bankruptcy less than four months later, binds the trustee if he fails to appeal—and also a purchaser from the trustee of the property subject to the lien); *In re Cup Craft Paper Corp.*, 40 F. Supp. 927 (S.D.N.Y. 1941) (trustee substituted for plaintiff bankrupt).

Normal principles of judicial finality also govern the effect of judgments rendered in actions in which the trustee takes over and prosecutes or defends with the approval of the bankruptcy court. See *Sherman v. Buckley*, 119 F.2d 280 (2d Cir.), *cert. denied*, 314 U.S. 657 (1941).

8. *Heiser v. Woodruff*, *supra* note 7, at 735 ("In general a judgment is *res judicata* not only as to all matters litigated and decided by it, but as to all relevant issues which could have been but were not raised and litigated in the suit."); see *Pepper v. Litton*, 308 U.S. 295 (1939).

in other litigation.⁹ Even though a creditor may have established his claim against the trustee in the nonbankruptcy litigation, however, the bankruptcy court may subordinate the judgment to claims of other creditors when equitable principles so warrant.¹⁰

Further elements of the general law governing recognition of a judicial decision are applicable in the area of bankruptcy. A judgment must be final before it has any res judicata or collateral estoppel effect,¹¹ although a bankruptcy decree that is interlocutory in some respects may be considered res judicata as to a particular matter of which it makes a final disposition.¹² A bankruptcy court is a court of authority and when it has obtained the in personam or in rem jurisdiction requisite to the nature of the proceeding involved, its final judgment is normally immune to collateral attack.¹³ Similar principles apply to final judgments rendered by nonbankruptcy courts of authority.¹⁴ The general rule against piecemeal litigation—which requires a party to present all grounds in support of a claim or defense—is applied in determining the res judicata effect of an adjudication rendered either by the bankruptcy court¹⁵ or a nonbankruptcy court.¹⁶ Similarly pertinent in the bankruptcy court or

9. See *Lawlor v. National Screen Serv. Corp.*, 349 U.S. 322 (1955); *Southern Pac. R.R. v. United States*, 168 U.S. 1, 48-49 (1897); *Cromwell v. County of Sac*, 94 U.S. 351 (1877); Cleary, *Res Judicata Reexamined*, 57 YALE L.J. 339 (1948); Polasky, *Collateral Estoppel—Effects of Prior Litigation*, 39 IOWA L. REV. 217 (1954); Scott, *Collateral Estoppel by Judgment*, 56 HARV. L. REV. 1 (1942).

10. See *Pepper v. Litton*, 308 U.S. 295 (1939); text at notes 210-15 *infra*.

11. See *G. & C. Merriam & Co. v. Saalfeld*, 241 U.S. 22, 28 (1916); 6 MOORE, *op. cit. supra* note 1, ¶¶ 54.42, 56.20[3].

12. *Chase v. Austrian*, 189 F.2d 555, 557 (4th Cir.), *cert. denied*, 341 U.S. 952 (1951) ("When a court has properly taken jurisdiction in a reorganization proceeding upon a finding of insolvency, that question may not be raised again in the proceeding."); *Mason v. Palo Verde Irr. Dist.*, 132 F.2d 714 (9th Cir. 1943) (ruling on former appeal that bankruptcy court had jurisdiction to confirm a plan of municipal debt adjustment is res judicata).

13. See *Chicot County Drainage Dist. v. Baxter State Bank*, 308 U.S. 371 (1940). However, under established doctrine, the circumstances in the second case must be the same as those in the first proceeding. See *West Coast Life Ins. Co. v. Merced Irr. Dist.*, 114 F.2d 654 (9th Cir. 1940), *cert. denied*, 311 U.S. 718 (1941) (holding that disallowance of chapter IX composition on theory that the chapter was unconstitutional did not preclude a second proceeding under a subsequently enacted chapter IX creating new rights and liabilities).

14. *Heiser v. Woodruff*, 327 U.S. 726 (1946); *Fox v. McGrath*, 152 F.2d 616 (2d Cir. 1945), *cert. denied*, 327 U.S. 806 (1946) (reorganization court will not sustain a collateral attack upon a pre-bankruptcy state court judgment and the lien created thereby because of harmless procedural error); *In re Redwine*, 53 F. Supp. 249 (N.D. Ala. 1944); *cf. Kalb v. Feuerstein*, 308 U.S. 433 (1940) (concerning the effect of a § 75 proceeding as a statutory stay upon the validity of state court proceedings taken subsequent to the filing of the § 75 petition).

15. *First Nat'l Bank v. Luther*, 217 F.2d 262 (10th Cir. 1954); *Meinhard, Greeff & Co. v. Brown*, 199 F.2d 70 (4th Cir. 1952); *Brack v. Gross*, 186 F.2d 940 (4th Cir. 1951).

16. *Heiser v. Woodruff*, 327 U.S. 726 (1946); *In re Redwine*, 53 F. Supp. 249 (N.D. Ala. 1944).

in nonbankruptcy suits are the doctrines calling for an election of inconsistent remedies¹⁷ and for an estoppel of one claiming benefits under a judgment.¹⁸

Problems of privity tend to become more complex in the bankruptcy area than in other fields. Absent fraud or some other avoiding ground, both in rem¹⁹ and in personam²⁰ judgments rendered against a debtor prior to bankruptcy are binding upon the bankruptcy trustee. This privity of estate between the bankrupt and his trustee extends to the situation where an in rem suit is pending against the debtor's property at the time of the latter's bankruptcy. If the suit is not stayed,²¹ the trustee is bound by an in rem judgment

17. See *Friend v. Talcott*, 228 U.S. 27 (1913); *First Nat'l Bank v. Luther*, 217 F.2d 262 (10th Cir. 1954); *Kuhl v. Hayes*, 212 F.2d 37 (10th Cir. 1954); *Parker v. United States*, 153 F.2d 66 (1st Cir. 1946). See also notes 119, 163 *infra*. For general discussion of election of inconsistent remedies, see *United States v. Oregon Lumber Co.*, 260 U.S. 290 (1922); *Friedrichsen v. Renard*, 247 U.S. 207 (1918); *Smith v. Kirkpatrick*, 305 N.Y. 66, 111 N.E.2d 209, 110 N.Y.S.2d 397 (1953); *Terry v. Munger*, 121 N.Y. 161, 24 N.E. 272 (1890).

18. See *Davis v. Wakelee*, 156 U.S. 680 (1895).

19. *In re Mercury Engineering*, 68 F. Supp. 376 (S.D. Cal. 1946). The bankruptcy trustee is not, however, precluded from suing to set aside a bankrupt's mortgage as fraudulent, although the mortgage is being foreclosed. *Berrara v. City Real Estate Co.*, 64 F.2d 498 (2d Cir. 1933).

20. *Fox v. McGrath*, 152 F.2d 616 (2d Cir. 1945), *cert. denied*, 327 U.S. 806 (1946); *In re Redwine*, 53 F. Supp. 249 (N.D. Ala. 1944). See *Heiser v. Woodruff*, 327 U.S. 726 (1946). Divergent opinion exists, however, as to the res judicata effect of an in personam judgment rendered against the debtor after bankruptcy. See note 238 *infra* and accompanying text.

21. See, e.g., *In re Winter*, 17 F.2d 153 (E.D. Mich. 1927).

In reorganization proceedings, where the plan of reorganization may and usually does deal with secured debt, the reorganization court has extensive power to stay in rem suits against the debtor's property and to deal with that property and the secured creditor in the plan of reorganization. See *Emil v. Hanley*, 318 U.S. 515 (1943); 6 COLLIER ¶¶ 3.09[1], 3.15, 3.28, 3.29, 3.33, 6.12.

In bankruptcy, the aim is liquidation for the benefit of unsecured creditors. Accordingly, the bankruptcy court may temporarily stay a pending in rem suit to give a bankruptcy receiver or trustee the opportunity to protect the estate's interest, if any, in the property. The court should not, however, permanently enjoin the in rem suit, *In re Lustron Corp.*, 184 F.2d 789 (7th Cir. 1950), *cert. denied*, 340 U.S. 946 (1951), unless it comes within the category of in rem suits that are superseded by bankruptcy—for example, a general equity receivership in which the receiver was appointed within four months of bankruptcy and during that time the debtor was insolvent or unable to pay his debts as they matured, see Bankruptcy Act § 2a(21), 66 Stat. 420, 11 U.S.C. § 11a(21) (1952); § 3a(5), 30 Stat. 546 (1898), as amended, 11 U.S.C. § 21a(5) (1952); § 3b, 30 Stat. 546 (1898), as amended, 11 U.S.C. § 21b (1952); *Emil v. Hanley*, *supra*,—or unless the in rem suit created a judicial lien within four months of bankruptcy and at a time when the debtor was solvent. In the latter situation, the bankruptcy court has summary jurisdiction to hear and determine the rights of the parties; if the lien was created within four months of bankruptcy and the debtor was then insolvent, the judicial lien is avoided or preserved for the benefit of the estate by virtue of § 67a. This means that the judicial lien creditor gains no advantage by virtue of his lien, and that the bankruptcy

rendered subsequent to bankruptcy, whether or not he appears in the action.²² But by majority rule, if the pending action against the debtor is in personam, a judgment rendered after the debtor's bankruptcy—at least after adjudication of bankruptcy—does not bind the trustee unless he appeared in the in personam action, since the Bankruptcy Act contemplates a different method of liquidating in personam claims against the bankrupt estate.²³ When a company in receivership sells its assets to a corporation which subsequently becomes bankrupt, the vendee corporation and its successor in title, the bankruptcy trustee, are in privity with the vendor company so that the bankruptcy trustee can avail himself of a receivership adjudication establishing company ownership of property claimed by a general creditor.²⁴ A successor trustee in bankruptcy is in privity with, and is bound by a judgment against, the original trustee.²⁵ Moreover, if a trustee transfers the property or the claim which was the subject of the

court may liquidate the property for the benefit of the unsecured creditors, including the judicial lien creditor. On the other hand, if the judicial lien cannot be avoided under § 67a because it was obtained more than four months before bankruptcy, or within four months but at a time when the debtor was solvent, an in rem suit creating or brought to enforce the lien should be allowed to continue. *Straton v. New*, 283 U.S. 318 (1931); 1 COLLIER ¶ 2.63.

In rem suits brought to enforce other types of liens or interests, as, for example, an action to foreclose a consensual (mortgage) or statutory lien, should not be permanently stayed if instituted *before* bankruptcy, *Emil v. Hanley*, *supra*; *In re Lustron Corp.*, *supra*, even though such a suit may not be instituted *after* bankruptcy without bankruptcy court permission, *Isaacs v. Hobbs Tie & Timber Co.*, 282 U.S. 734 (1931). Permission may and should be given upon a showing by the mortgagee that since the mortgaged property has less value than the amount of the mortgage debt, the bankrupt's estate can have no interest in the property. *Isaacs v. Hobbs Tie & Timber Co.*, 76 F.2d 209 (5th Cir. 1935); Note, 17 MINN. L. REV. 47 (1932); Comment, 41 YALE L.J. 445 (1932).

Subject to the foregoing qualifications, the broad rule applicable in *bankruptcy* is that the first court to obtain in rem jurisdiction, whether nonbankruptcy or bankruptcy, has the right to proceed to judgment and liquidate the property which is the subject of the in rem suit. For purposes of determining this priority, the bankruptcy court's in rem jurisdiction attaches when the bankruptcy petition is filed. *Isaacs v. Hobbs Tie & Timber Co.*, 282 U.S. 734 (1931).

For the effect of a proceeding under the Bankruptcy Act which operates as a statutory stay upon nonbankruptcy in rem proceedings, see *Kalb v. Feuerstein*, 308 U.S. 433 (1940), discussed in text at notes 49-52 *infra*.

22. *Eyster v. Gaff*, 91 U.S. 521 (1875); *Clark v. Mutual Lumber Co.*, 206 F.2d 643 (5th Cir. 1953); *Linstroth Wagon Co. v. Ballew*, 149 Fed. 960 (5th Cir. 1907); *Stark v. Baltimore Soda Fountain Mfg. Co.*, 101 F. Supp. 842 (D. Md. 1952) (replevin suit in Maryland is a suit in rem wherein plaintiff must prove his title to the property sought to be replevied); *In re Winter*, *supra* note 21; *In re Goetz*, 289 Fed. 118, 120 (D. Ariz. 1923) ("The trustee need not intervene; but if he does not, he is bound by the judgment to the same extent that any party acquiring an interest in the property pending suit is bound."); 1 COLLIER ¶ 11.09. For the situation where there is fraud, see *Berrara v. City Real Estate Co.*, 64 F.2d 498 (2d Cir. 1933).

23. See text accompanying note 238 *infra*.

24. *In re Weisbrod & Hess Corp.*, 129 F.2d 114 (3d Cir. 1942).

25. *Hummel v. Equitable Life Assur. Soc.*, 151 F.2d 994 (7th Cir. 1945).

suit after a judgment is rendered against him, the judgment binds the trustee's transferee.²⁶

In summary, then, since under section 70a of the Bankruptcy Act the trustee succeeds to the bankrupt's property, the trustee is properly in privity of estate with the bankrupt as to that property at the time of bankruptcy. Generally, also, the trustee is so far in privity with the bankrupt that in personam judgments rendered prior to bankruptcy against the bankrupt and in favor of creditors are binding upon the trustee. In considering these general propositions, however, one must remember that the Bankruptcy Act empowers the trustee, under certain circumstances, to avoid judicial liens²⁷ and preferential,²⁸ fraudulent,²⁹ and other proscribed transfers,³⁰ for the benefit of the unsecured creditors he represents. And, further, judgments obtained against the bankrupt by fraud or collusion may not be binding upon the creditors' representative, their trustee.³¹ Thus, the idea of the trustee's privity with the bankrupt will not be pushed to the point that the estate is bound by judgments that would defeat the proper

26. *Fischer v. Pauline Oil & Gas Co.*, 309 U.S. 294, 303 (1940) (property transfer); *United States v. New York Terminal Warehouse Co.*, 233 F.2d 238, (5th Cir. 1956) (transfer of claim).

In the *New York Terminal Warehouse* case, a creditor possessed, as a holder in due course, negotiable warehouse receipts issued against the debtor's property, which he held as collateral. He transferred these receipts to the bankruptcy trustee, who then brought suit against the warehouseman. The warehouseman successfully defended on the basis of personal defenses good against the bankrupt; whereupon the trustee retransferred the receipts to the holder in due course. The court held that the judgment against the trustee was res judicata and concluded the holder in due course. In the trustee's unsuccessful action against the warehouseman, the appellate tribunal had determined that the trustee stood in the bankrupt's shoes and not in those of the holder in due course and that he therefore was subject to those defenses the warehouse company could assert against the bankrupt. In later holding that the judgment against the trustee precluded recovery by the holder in due course, the court said:

It is quite a novel suggestion that a holder in due course may transfer its note secured by warehouse receipts to one who takes subject to personal defenses and, after suit by such holder on the receipts has resulted in judgment for the warehouseman, has the right to take a retransfer of the warehouse receipts and then sue again on the the same receipts. The government cites no authority to support such a proposition. We know of none. The one case, *New Orleans Gas Light Co. v. Webb*, 7 La. Ann. 164, does not support this thesis.

Id. at 240.

27. Bankruptcy Act § 67a, 30 Stat. 564 (1898), as amended, 11 U.S.C. § 107(a) (1952); see *Fischer v. Pauline Oil & Gas Co.*, *supra* note 26, 53 HARV. L. REV. 1043 (1940); note 21 *supra*.

28. Bankruptcy Act § 60b, 30 Stat. 562 (1898), as amended, 11 U.S.C. § 96(b) (1952).

29. Bankruptcy Act § 67d(2), 30 Stat. 564 (1898), as amended, 11 U.S.C. § 107(d) (2) (1952); § 70(e) (1), 52 Stat. 882 (1938), 11 U.S.C. § 110(e) (1) (1952).

30. Bankruptcy Act § 67(c), 30 Stat. 564 (1898), as amended, 11 U.S.C. § 107(c) (1952); § 70(c), 52 Stat. 881 (1938), as amended, 11 U.S.C. § 110(c) (1952); § 70(e) (1), 52 Stat. 882 (1938), 11 U.S.C. § 110(e) (1) (1952).

31. See discussion of *Pepper v. Litton* and *Heiser v. Woodruff* in text accompanying notes 209-26 *infra*.

and just objectives of the Bankruptcy Act.³² Subject to these qualifications, the general principles of privity³³ are applicable in bankruptcy.³⁴

COLLATERAL ATTACK AGAINST BANKRUPTCY JUDGMENTS

A more detailed treatment of res judicata problems can now be offered regarding the first matter of broad concern mentioned at the outset—the effect in the same or other proceedings of judgments rendered by a bankruptcy court. It is important to bear in mind, as an initial proposition, that the bankruptcy tribunal is a federal district court of authority and power. This is well illustrated by two cases, *Stoll v. Gottlieb*³⁵ and *Chicot County Drainage Dist. v. Baxter State Bank*,³⁶ which, incidentally, are leading cases in general support of judicial finality as against collateral attack. In *Stoll*, as part of a reorganization plan approved by the district court under section 77B, the guarantor of the debtor's bonds was released from his obligation for a stated consideration. Ninety-six per cent of the bondholders had accepted the plan. One bondholder of the remaining four per cent, whose motion to vacate the court's orders on the ground that it lacked jurisdiction to cancel the guaranty was denied, thereafter instituted suit in an Illinois state court to recover on the guaranty. On certiorari to the Illinois court, the United States Supreme Court expressly declined to consider whether the bankruptcy court had properly assumed jurisdiction over the liabilities of the guarantor. It held that the bankruptcy court's finding of jurisdiction was res judicata and invulnerable to collateral attack, at least by a party to that determination. Thus, the basic doctrine that, once the question has been litigated, a finding of jurisdiction over the person becomes res judicata,³⁷ has been definitely extended to the more delicate problem of jurisdiction over the subject matter.

Further implications appear in the *Chicot County* case. There, the issue was the validity of a decree, entered by a bankruptcy court sitting in Arkansas,

32. See *Berrara v. City Real Estate Co.*, 64 F.2d 498 (2d Cir. 1933); cf. *Clark v. Mutual Lumber Co.*, 206 F.2d 643 (5th Cir. 1953).

33. See *Kersh Lake Drainage Dist. v. Johnson*, 309 U.S. 485, 491 (1940); *Chicago, R.I. & Pac. Ry. v. Schendel*, 270 U.S. 611 (1926); *Hartford Acc. & Indem. Co. v. Jasper*, 144 F.2d 266 (9th Cir. 1944); *McVeigh v. McGurren*, 117 F.2d 672, 678 (7th Cir.), cert. denied, 313 U.S. 573 (1941); *Byrum v. Ames & Webb, Inc.*, 196 Va. 597, 85 S.E.2d 364 (1955); cf. *Bruszewski v. United States*, 181 F.2d 419, 423 (3rd Cir.), cert. denied, 340 U.S. 865 (1950), 64 HARV. L. REV. 509 (1951), 36 VA. L. REV. 963 (1950).

34. Cases cited notes 19-22 *supra*; *Fischer v. Pauline Oil & Gas Co.*, 309 U.S. 294 (1940); *United States v. New York Terminal Warehouse Co.*, 233 F.2d 238 (5th Cir. 1956); *Hummel v. Equitable Life Assur. Soc.*, 151 F.2d 994 (7th Cir. 1945); *In re Weisbrod & Hess Corp.*, 129 F.2d 114 (3d Cir. 1942); *In re Redwine*, 53 F. Supp. 249 (N.D. Ala. 1944); *Hall v. Main*, 34 F.2d 528 (E.D. Ill. 1929), *aff'd* 41 F.2d 715 (7th Cir. 1930) (discussing privity of estate).

35. 305 U.S. 165 (1938), 39 COLUM. L. REV. 274 (1939), 6 U. CHI. L. REV. 293 (1939), 25 VA. L. REV. 725 (1939), Note, 48 YALE L.J. 879 (1939).

36. 308 U.S. 371 (1940), 26 A.B.A.J. 167, Note, 49 YALE L.J. 959. See also Note, *Res Judicata and Jurisdiction: The Bootstrap Doctrine*, 53 HARV. L. REV. 652 (1940).

37. See *Baldwin v. Iowa State Traveling Men's Ass'n*, 283 U.S. 522 (1931).

confirming a plan of composition under the original chapter IX of the Bankruptcy Act—"Municipal Debt Readjustments." This decree made certain provisions for the bondholders and then cancelled the Chicot County Drainage District bonds. Subsequently, in an entirely different case between other parties which had begun in a bankruptcy court in Texas, the Supreme Court held that chapter IX was unconstitutional.³⁸ Still later, certain bondholders of the Drainage District who had not appeared in the Arkansas bankruptcy proceeding, although they had had proper notice,³⁹ brought an action at law on their bonds against the Drainage District in the same federal district court which had earlier confirmed the bankruptcy composition. The Drainage District pleaded the composition decree in bar and was upheld by the Supreme Court. Speaking for the Court, Chief Justice Hughes stated:

The courts below have proceeded on the theory that the Act of Congress having been found to be unconstitutional, was not a law; that it was inoperative, conferring no rights and imposing no duties, and hence affording no basis for the challenged decree. . . .

. . . . Apart from the contention as to the effect of the later decision as to constitutionality, all the elements necessary to constitute the defense of *res judicata* are present. It appears that the proceedings in the District Court to bring about a plan of readjustment were conducted in complete conformity to the statute. The Circuit Court of Appeals observed that no question had been raised as to the regularity of the court's action. . . . As parties, these bondholders had full opportunity to present any objections to the proceeding, not only as to its regularity, or the fairness of the proposed plan of readjustment, or the propriety of the terms of the decree, but also as to the validity of the statute under which the proceeding was brought and the plan put into effect. Apparently no question of validity was raised and the cause proceeded to decree on the assumption by all parties and the court itself that the statute was valid. There was no attempt to review the decree. If the general principles governing the defense of *res judicata* are applicable, these bondholders, having the opportunity to raise the question of invalidity, were not the less bound by the decree because they failed to raise it. . . .

. . . . The argument is pressed that the District Court was sitting as a court of bankruptcy, with the limited jurisdiction conferred by statute, and that, as the statute was later declared to be invalid, the District Court was without jurisdiction to entertain the proceeding and hence its decree is open to collateral attack. We think the argument untenable. The lower federal courts are all courts of limited jurisdiction, that is, with only the jurisdiction which Congress has prescribed. But none the less they are courts with authority, when parties are brought before them in accordance with the requirements of due process, to determine whether or not they have jurisdiction to entertain the cause and for this purpose to construe and apply the statute under which they are asked to act. Their deter-

38. *Ashton v. Cameron County Water Improvement Dist.*, 298 U.S. 513 (1936). A subsequently enacted chapter IX was sustained in *United States v. Bekins*, 304 U.S. 27 (1938).

39. These facts clearly appear in the lower court opinion. See *Chicot County Drainage Dist. v. Baxter State Bank*, 103 F.2d 847, 848 (8th Cir. 1939).

mination of such questions, while open to direct review, may not be assailed collaterally.⁴⁰

Thus, it makes no difference whether the challenged action is taken, as in the *Stoll* case, under a valid statute, or, as in the *Chicot* case, under a statute subsequently invalidated in another proceeding. Nor is it significant that the party raised lack of jurisdiction, as in *Stoll*, or failed to do so, as in *Chicot*. For, as further stated in the latter case, it is a "well-settled principle that *res judicata* may be pleaded as a bar, not only as respects matters actually presented to sustain or defeat the right asserted in the earlier proceeding, 'but also as respects any other available matter which might have been presented to that end.'"⁴¹ This application of *res judicata* does not, of course, mean that parties to the bankruptcy action have no opportunity to challenge the court's finding of jurisdiction over the subject matter. The remedy for an erroneous finding, however, is a timely direct attack upon the court decree.

The *Stoll* and *Chicot* principles should furthermore be read in the light of the implicit assumption in both cases that the bankruptcy court has obtained the requisite jurisdiction over the parties for the decree rendered, in rem or in personam, as the case may be. Thus, the Supreme Court in *City of New York v. New York, New Haven & Hartford Railroad*⁴² sustained the city's collateral attack upon a railroad reorganization decree barring the city's tax liens, because the reorganization court failed to give the city reasonable notice. But if by appropriate process the bankruptcy court has obtained the requisite jurisdiction, it has power in the first instance to determine whether it has authority to proceed;⁴³ and any determination, even though erroneous, concerning its subject matter jurisdiction,⁴⁴ its right to proceed summarily,⁴⁵ or

40. 308 U.S. at 374-76. *But cf.* *Vallely v. Northern Fire & Marine Ins. Co.*, 254 U.S. 348 (1920). See also Note, 53 HARV. L. REV. 652 (1940).

For a collateral attack upon the decree of a state equity receivership court on the theory that the statute authorizing the state court proceedings was in conflict with the Bankruptcy Act and therefore invalid, see *International Shoe Co. v. Pinkus*, 278 U.S. 261 (1929).

41. 308 U.S. at 378.

42. 344 U.S. 293 (1953) (publication of bar order insufficient with respect to the city, which was a known lien creditor).

43. *Chicot County Drainage Dist. v. Baxter State Bank*, 308 U.S. 371 (1940); *Stoll v. Gottlieb*, 305 U.S. 165 (1938); *Harris v. Avery Brundage Co.*, 305 U.S. 160 (1938).

Furthermore, under the general principles of *Baldwin v. Iowa State Traveling Men's Ass'n*, 283 U.S. 522 (1931), when a party appears and challenges service of process—and thereby the court's in rem or in personam jurisdiction over him—the bankruptcy tribunal has power to bind the party in its decision of that issue.

44. *Union Joint Stock Land Bank v. Byerly*, 310 U.S. 1 (1940); *Chicot County Drainage Dist. v. Baxter State Bank*, *supra* note 43; *Stoll v. Gottlieb*, *supra* note 43; *United States ex rel. Emanuel v. Jaeger*, 117 F.2d 483 (2d Cir. 1941).

45. *Sampsell v. Imperial Paper & Color Corp.*, 313 U.S. 215, 218-19 (1941); *Harris v. Avery Brundage Co.*, 305 U.S. 160, 163 (1938) ("In every case the bankruptcy court has power, in the first instance, to determine whether it has that actual or constructive

the merits⁴⁶ is *res judicata* and immune to collateral attack. Since the referee acts as a court of bankruptcy except in those matters which the Bankruptcy Act or the General Orders reserve to the district judge alone, these principles apply to orders of the referee as well as to those of the judge.⁴⁷

Bankruptcy court adjudications, then, have at least as much effect as judgments of other courts of general authority. Under certain circumstances, indeed, state court judgments may be more vulnerable than comparable bankruptcy court proceedings because of the paramountcy of the Bankruptcy Act and the plenary powers it vests in the bankruptcy court. The point is particularly well illustrated by the following cases.⁴⁸

possession [of property] which is essential to its [summary] jurisdiction to proceed."); *Coffman v. Cobra Mfg. Co.*, 214 F.2d 489, 491-92 (9th Cir. 1954), *cert. denied*, 348 U.S. 912 (1955) ("All intendments are presumed in favor of the judgment. *Coffman* here is collaterally attacking a judgment of a court of competent jurisdiction exercising its power within its subject matter jurisdiction. This can only be done by showing a fatal defect on the face of the judgment roll, which is not claimed here.").

46. *Van Huffel v. Harkelrode*, 284 U.S. 225 (1931) (holding that bankruptcy court had power to sell realty free and clear of state tax lien; although it erred in giving priority in proceeds to a mortgagee, the order is entitled to *res judicata* effect in a suit by the vendee of a purchaser at a bankruptcy sale, to quiet title).

47. *In re Sterling*, 125 F.2d 104, 107 (9th Cir. 1942) ("No review of the referee's order was sought or obtained. . . . [T]herefore, the referee's order was and is conclusive; for the principles of *res judicata* apply as well to jurisdictional questions as to other questions, as well to bankruptcy cases as to other cases, and as well to decisions of referees as to those of judges."); *In re Tinkoff*, 85 F.2d 305, 307 (7th Cir. 1936), *cert. denied*, 299 U.S. 611 (1937) ("Adjudications of the referee, if not reviewed within the time and in the manner prescribed, have the force and effect of judgments and orders of the District Court."); *Mueller v. Elba Oil Co.*, 21 Cal. 2d 188, 130 P.2d 961 (1942); 2 COLLIER § 38.02; note 156 *infra*.

But, as mentioned in the text with respect to bankruptcy court decrees generally, before an order of a referee has *res judicata* effect upon a third person, the latter must be given appropriate notice or must voluntarily submit to the referee's jurisdiction. *Title & Trust Co. v. Wernich*, 68 F.2d 811 (9th Cir. 1934) (referee's order that maintenance expense become a charge against certain property superior to mortgagee's claim is not *res judicata* as to a mortgagee who was not notified and who did not participate in the hearing); *Coates v. Maguire Oil & Ref. Corp.*, 47 Cal. App. 2d 275, 117 P.2d 898 (Dist. Ct. App. 1941). Referees' orders enjoy the same presumption of jurisdiction given judgments of the district court. *In re Williams Supply Co.*, 77 F.2d 909 (2d Cir.), *cert. denied*, 296 U.S. 612 (1935). But see *Regoli v. Fancher*, 1 Cal. 2d 276, 280-81, 34 P.2d 477, 479 (1934) ("It is true the attack here is collateral, but this decree would seem clearly to be in no different status than a decree of a sister state or foreign country. . . . We know of no law that clothes the orders or decrees of a referee in bankruptcy with any presumption of jurisdiction over strangers to the proceeding."); *Woodward v. McDonald*, 116 Ga. 748, 42 S.E. 1030 (1902).

48. For other cases which exemplify the effect of Bankruptcy Act supremacy, see *International Shoe Co. v. Pinkus*, 278 U.S. 261 (1929). Compare *ibid.* with *Chicot County Drainage Dist. v. Baxter State Bank*, 308 U.S. 371 (1940). See also *In re Potts*, 142 F.2d 883 (6th Cir. 1944) (applying the statutory stay theory of *Kalb v. Feuerstein*, 308 U.S. 433 (1940), to a chapter XII proceeding in holding void a state court judgment rendered subsequent to the filing of the chapter XII petition).

*Kalb v. Feuerstein*⁴⁹ involved a proceeding by a farmer-debtor under section 75, the agricultural and composition provisions. The Court took the position that the stay provided for in section 75 is automatic and that even though no judicial stay had been obtained from the bankruptcy court, further proceedings in a pending state foreclosure action taken subsequent to the composition petition were void and subject to collateral attack.⁵⁰ *Union Joint Stock Land Bank v. Byerly*⁵¹ held, however, that if a bankruptcy court modifies a stay order under section 75, albeit erroneously, state court proceedings taken in accordance with the modified stay may not be collaterally attacked. Justice Roberts stated:

In view of the provisions of subsection (o), it was error for the District Court, in the absence of the preliminary steps required by that subsection, to permit the sheriff to hold the sale [*Kalb v. Feuerstein, supra*]. But the court had jurisdiction in the premises. Error committed by it in the exercise of that jurisdiction could have been corrected by appeal from its order. The state court and its officer, the sheriff, were entitled, in view of the District Court's plenary jurisdiction over the debtor and his property, to rely upon the order granting permission to make the sale. The District Court did not lose jurisdiction by erroneously construing or applying provisions of the statute under which it administered the bankrupt estate. Its order was voidable, but not void, and was not to be disregarded or attacked collaterally in the state court.⁵²

The Court further held that the state court's confirmation of the foreclosure sale during the interim between the dismissal and reinstatement of the section 75 proceedings was not subject to collateral attack in the reinstated bankruptcy proceeding.⁵³

49. 308 U.S. 433 (1940), 28 GEO. L.J. 1129, 24 MINN. L. REV. 981, 1940 WIS. L. REV. 424.

50. The precise holding of the *Kalb* case is narrow; further proceedings in the pending state foreclosure after the filing of the § 75 petition may be null and void only when the right of the state court to proceed is not put in issue and decided. Thus, if after the § 75 petition has been filed, the mortgagee appropriately raises the issue of his right to proceed in the state court and gives due notice to the defendant, and the defendant either fails to object or, having objected, is overruled, a court, without overruling *Kalb*, could well hold that any further state court proceedings are immune from collateral attack. Its decision would be supported by ample authority to the effect that once a court of competent jurisdiction, like a state court, has perfected jurisdiction over the defendant, it has jurisdiction to decide its power to adjudicate.

Nevertheless, the theory of the *Kalb* case seems to be that Congress deprived the state courts of the power to decide the effect of § 75 petitions upon their jurisdiction and committed the matter to the bankruptcy courts. See *United States v. Williams*, 341 U.S. 58, 67 (1951) ("We . . . held [in *Kalb*] that the Federal Government, in the exercise of its plenary power over bankruptcy, had ousted state courts of all independent power over farmer bankrupts. Therefore any subsequent orders in the state courts were void.").

51. 310 U.S. 1 (1940).

52. *Id.* at 7-8.

53. *Ibid.*; accord, *Federal Land Bank v. Putnam*, 350 Pa. 533, 39 A.2d 586 (1944), cert. denied, 324 U.S. 882 (1945) (holding that after farmer-debtor proceeding instituted by mortgagor had been dismissed by the bankruptcy court, and state court denied

In brief, then, judgments of the bankruptcy court are normally immune to collateral attack⁵⁴ and may be relied upon by state courts.⁵⁵ When the judgment is final and valid it is entitled to full faith and credit⁵⁶ and should be given appropriate res judicata or collateral estoppel effect in a state court.⁵⁷ Similarly, such a bankruptcy judgment has res judicata and collateral estoppel effect in the same bankruptcy proceeding,⁵⁸ in another bankruptcy proceeding⁵⁹ and in other proceedings in the same or a different federal court.⁶⁰

IN REM OR IN PERSONAM EFFECT OF BANKRUPTCY DECREES

The Adjudication of Bankruptcy

The principles governing the range of effect given to various bankruptcy decrees are appropriately introduced with an illustration based on the in rem decree adjudging the debtor a bankrupt. In *Gratiot County State Bank v. John-*

mortgagor's petition to set aside sheriff's sale of mortgaged land, issue of state court's jurisdiction was res judicata and could not be raised by mortgagor in subsequent proceeding for possession of the realty by purchaser at sheriff's sale).

54. *Union Joint Stock Land Bank v. Byerly*, 310 U.S. 1 (1940); *Chicot County Drainage Dist. v. Baxter State Bank*, 308 U.S. 371 (1940); *Stoll v. Gottlieb*, 305 U.S. 165 (1938); *Van Huffel v. Harkelrode*, 284 U.S. 225 (1931); *Coffman v. Cobra Mfg. Co.*, 214 F.2d 489 (9th Cir. 1954), *cert. denied*, 348 U.S. 912 (1955); *In re Sterling*, 125 F.2d 104 (9th Cir. 1942); *In re Walrath*, 175 Fed. 243 (N.D.N.Y. 1910); *In re Mason*, 99 Fed. 256 (W.D.N.C. 1900). *But cf.* *Valley v. Northern Fire & Marine Ins. Co.*, 254 U.S. 348 (1920). For collateral attack based on the lack of requisite service of process, see *City of New York v. New York, N.H. & H.R.R.*, 344 U.S. 293 (1953). For the requirement of proper notice as a requisite to the validity of a referee's order, see note 47 *supra*.

55. *Union Joint Stock Land Bank v. Byerly*, *supra* note 54; *Federal Land Bank v. Putman*, 350 Pa. 533, 39 A.2d 586 (1944), *cert. denied*, 324 U.S. 882 (1945).

56. *Stoll v. Gottlieb*, 305 U.S. 165 (1938); *Myers v. International Trust Co.*, 263 U.S. 64 (1923); *Mueller v. Elba Oil Co.*, 21 Cal. 2d 188, 130 P.2d 961 (1942); *Sampsell v. Gittelman*, 55 Cal. App. 2d 208, 130 P.2d 486 (Dist. Ct. App. 1942).

57. *Stoll v. Gottlieb*, *supra* note 56; *Van Huffel v. Harkelrode*, 284 U.S. 225 (1931); *Myers v. International Trust Co.*, *supra* note 56; *Mueller v. Elba Oil Co.*, *supra* note 56; *Sampsell v. Gittelman*, *supra* note 56 (finding in bankruptcy turnover order that bankrupt concealed \$13,592 from trustee is conclusive against the bankrupt in trustee's suit in state court to recover from the bankrupt an in personam judgment for that amount); *Clendenen v. Red River Valley Nat'l Bank*, 12 N.D. 51, 94 N.W. 901 (1903).

58. *Maggio v. Zeitz*, 333 U.S. 56 (1948) (turnover order); *Sampsell v. Imperial Paper & Color Corp.*, 313 U.S. 215 (1941); *In re Walrath*, 175 Fed. 243 (N.D.N.Y. 1910) (order of adjudication not subject to collateral attack in hearing on application for discharge); *In re Mason*, 99 Fed. 256 (W.D.N.C. 1900) (similar).

59. *Perlman v. 322 W. Seventy-Second St. Co.*, 127 F.2d 716 (2d Cir. 1942). See also *Duggan v. Sansberry*, 327 U.S. 499 (1946).

60. *Chicot County Drainage Dist. v. Baxter State Bank*, 308 U.S. 371 (1940); *Coffman v. Cobra Mfg. Co.*, 214 F.2d 489 (9th Cir. 1954), *cert. denied*, 348 U.S. 912 (1955); *United States v. Coast Wineries, Inc.*, 131 F.2d 643 (9th Cir. 1942); *United States ex rel. Emanuel v. Jaeger*, 117 F.2d 483 (2d Cir. 1941) (unsuccessful attack by habeas corpus upon bankruptcy contempt and commitment orders); *Maryland Cas. Co. v. United States*, 91 Ct. Cl. 203, 32 F. Supp. 746 (1940).

son,⁶¹ an involuntary petition was filed alleging that the debtor, while insolvent, had made preferential payments to a certain bank within four months prior to the filing of the petition. These allegations were sustained in the special master's report, which the court confirmed. The bank was not a party to these proceedings. After this adjudication, the trustee sued the bank in a state court to recover the illegal preferences. The bank admitted the payments but denied that the bankrupt was insolvent at the time the payments were made. The state court held that the bankruptcy court adjudication was conclusive upon the issue of insolvency, but the United States Supreme Court reversed on the ground that the factual determination of insolvency, however essential for the bankruptcy adjudication, could not bind a "preferred" creditor who was not a party to the prior proceeding. Justice Brandeis explained:

The adjudication is, for the purpose of administering the debtor's property, that is, in its legislative effect, conclusive upon all the world. . . . So far as it declares the status of the debtor, even strangers to the decree may not attack it collaterally. . . . But an adjudication in bankruptcy, like other judgments in rem, is not res judicata as to the facts or as to the subsidiary questions of law on which it is based, except as between parties to the proceeding or privies thereto.⁶²

And the fact that, as the Bankruptcy Act then read, the bank had a permissive right to intervene in opposition to the involuntary bankruptcy petition, did not make the bank a party. Whether or not a creditor exercises his permissive right to intervene, said Justice Brandeis,

he will be bound, like the rest of the world, by the judgment, so far as it is strictly an adjudication of bankruptcy. But he is under no obligation to intervene, and the existence of the right is not equivalent to actual intervention. Unless he exercises the right to become a party, he remains a stranger to the litigation and, as such, unaffected by the decision of even essential subsidiary issues. . . . The rule is general that persons who might have made themselves parties to a litigation between strangers, but did not, are not bound by the judgment.⁶³

Similarly, the adjudication of a partnership is, for the purposes of administering partnership property, good as against the world as an in rem adjudication that the partnership is a bankrupt. But as to an alleged partner over whom the bankruptcy court did not have jurisdiction, the adjudication is not conclusive that he is a partner.⁶⁴ Moreover, since a stranger to the bankruptcy

61. 249 U.S. 246 (1919).

62. 249 U.S. at 248; *accord*, *In re Walrath*, 175 Fed. 243 (N.D.N.Y. 1910) (on hearing of application for discharge); *In re Mason*, 99 Fed. 256 (W.D.N.C. 1900) (similar); 2 COLLIER ¶ 18.50; *cf.* *Valley v. Northern Fire & Marine Ins. Co.*, 254 U.S. 348 (1920); 2 COLLIER ¶ 18.48.

63. 249 U.S. at 249-50.

64. *Manson v. Williams*, 213 U.S. 453 (1909); *Carter v. Whisler*, 275 Fed. 743 (8th Cir. 1921); *Tate v. Hoover*, 345 Pa. 19, 26 A.2d 665, *cert. denied*, 317 U.S. 677 (1942); 1 COLLIER ¶ 5.14.

adjudication is not bound by the decision of underlying issues, he may not, if mutuality is adhered to,⁶⁵ claim in an in personam suit against the bankrupt that a prior favorable decision of underlying issues has a collateral estoppel effect benefitting him.⁶⁶

Apart from the question of parties and privity, attention must be paid to what was adjudged. If an involuntary petition charges several acts of bankruptcy and the decree does not indicate upon which one it is based, the adjudication is not collaterally conclusive of any act, either in the subsequent bankruptcy proceedings⁶⁷ or in a nonbankruptcy action.⁶⁸ So, too, if the alleged bankrupt denies both indebtedness to the petitioning creditor and insolvency, if the involuntary petition is dismissed because insolvency was not proved, and if the validity of the petitioning creditor's claim is not involved in the determination of insolvency, then the judgment of dismissal establishes nothing relative to the validity of the claim; and accordingly, the decision has no collateral estoppel effect in a subsequent suit by the petitioning creditor against the debtor on his claim.⁶⁹ And since insolvency is not an essential element of voluntary bankruptcy, adjudication of a petitioning debtor as a bankrupt is not collaterally conclusive of insolvency.⁷⁰

*Myers v. International Trust Co.*⁷¹ expounds both the principles of res judicata and collateral estoppel as applied to a composition decree. The bankruptcy court, over a creditor's objection that the bankrupts had obtained credit from it by a false financial statement, confirmed a composition after finding that the financial statement was true when made. Subsequently, the creditor sued the former bankrupts for deceit on the basis of the same financial statement, and the Supreme Court held that the bankruptcy court's finding—that the statement was true—was conclusive against the plaintiff-creditor. Applying the principles of the leading case on collateral estoppel (or estoppel by judgment), *Cromwell v. County of Sac*,⁷² Chief Justice Taft pointed out that res judicata was not involved, for "the opposition to the composition in the bankruptcy court was not the same cause of action as the suit for deceit here."⁷³ Nevertheless, under the principles of collateral estoppel, the bankruptcy court's finding as to the truth of the financial statement precluded the creditor from again litigating this issue:

65. For discussion of mutuality, see *Bigelow v. Old Dominion Copper Mining & Smelting Co.*, 225 U.S. 111, 127 (1912); Currie, *Mutuality of Collateral Estoppel: Limits of the Bernhard Doctrine*, 9 STAN. L. REV. 281 (1957).

66. *Casco Mercantile Trust Co. v. Seidel*, 127 Me. 286, 143 Atl. 101 (1928).

67. *Carter v. Whisler*, 275 Fed. 743 (8th Cir. 1921); *In re Julius Bros.*, 217 Fed. 3 (2d Cir. 1914) (on bankrupt's right to discharge); *In re Letson*, 157 Fed. 78 (8th Cir. 1907).

68. *Casco Mercantile Trust Co. v. Seidel*, 127 Me. 286, 143 Atl. 101 (1928).

69. *Granite City Bank v. Tvedt*, 146 Minn. 12, 177 N.W. 767 (1920).

70. *People's Nat'l Bank v. Foltz*, 25 F.2d 295 (6th Cir. 1928).

71. 263 U.S. 64 (1923).

72. 94 U.S. 351 (1876).

73. 263 U.S. at 71.

An adjudication of bankruptcy, or of discharge therefrom, is a judgment *in rem* and is binding on, and *res judicata* as to, all the world, only in respect of the status of the bankrupt, and is not conclusive as to the findings of fact or subsidiary questions of law on which it is based except as between parties to the proceedings or privies thereto. . . . Here the International Trust Company was a real party to the issue and conducted the litigation. While the creditors whom it represented on the question of the discharge were only concluded as to the status of the bankrupt, it was estopped as between itself and the bankrupts in respect of the relevant facts determined in the controversy exactly as if the proceeding in opposition to the composition and discharge had been an ordinary civil suit by it against them.⁷⁴

If, however, the bankruptcy court, believing that the issue was immaterial as a matter of law, had failed to find the truth of the statement, the creditor would not have been collaterally estopped on this issue, even though the bankruptcy court might have erred as to its legal theory.⁷⁵

Whether a summary proceeding involving the trustee and a third person is *in rem* or *in personam* is determined by its nature and objective, just as those factors determine the character of a plenary action. The bankruptcy court has summary jurisdiction to determine claims in and to property over which it has actual or constructive possession.⁷⁶ A summary proceeding brought by the trustee to quiet his title to such property as against adverse claimants is *in rem* in character.⁷⁷ On the other hand, because a turnover proceeding brought against the bankrupt or a third person is in the nature of an action for a mandatory injunction to require the respondent to turn over specific property which he allegedly possesses or controls, it is *in personam* in character.⁷⁸ When directed to one over whom the bankruptcy court

74. *Id.* at 73.

75. In *Friend v. Talcott*, 228 U.S. 27 (1913), a creditor had objected to a composition and discharge on grounds that the bankrupt had issued a false financial statement. The bankruptcy court found that the financial statement was not made directly to the objecting creditor and was not, therefore, a legal ground for the denial of a discharge (see 1 COLLIER § 14.42); but the court did not determine whether the financial statement was true or false. Subsequently, the creditor sued for the amount of his claim, less the bankruptcy dividend, and he was held not to be precluded by the bankruptcy adjudication from showing the falsity of the statement.

76. See 5 MOORE, FEDERAL PRACTICE § 38.30[3] (2d ed. 1951).

77. For cases involving proceedings of this kind, see *Thompson v. Magnolia Petroleum Co.*, 309 U.S. 478 (1940); *City of Long Beach v. Metcalf*, 103 F.2d 483 (9th Cir.), *cert. denied*, 308 U.S. 602 (1939). For a bar order proceeding, also *in rem*, where the court's decree was held invalid as against a lien claimant because of inadequate notice, see *City of New York v. New York, N.H. & H.R.R.*, 344 U.S. 293 (1953).

78. *Sampsel v. Gittelman*, 55 Cal. App. 2d 208, 215, 130 P.2d 486, 490 (Dist. Ct. App. 1942) ("It [the turnover order] was not a judgment *in rem* but was directed to the specific performance of a definite act by appellant [the respondent] and no other. His position does not differ from that of a party who, once adjudged specifically to perform a contract, is later confronted with the decree of specific performance in an action for damages after his failure to perform."). Compare Justice Jackson's characterization of

has in personam jurisdiction, the turnover order is res judicata as to adjudged facts, such as respondent's possession of the property at that time, and is subject only to direct attack. In subsequent proceedings to punish respondent for civil contempt, while the respondent may not collaterally attack the turnover order, he is entitled to demonstrate his present inability to comply with it.⁷⁹ Such a showing should prevent his being adjudged contemptuous.⁸⁰ When it does not, but confinement has failed to produce the money or goods, "and where a reasonable interval of time has supplied the previous defect in the evidence, and has made sufficiently certain what was doubtful before, namely, the bankrupt's inability to obey the order, he has always been released."⁸¹

If in the turnover proceeding the court finds that the respondent has concealed an asset, the trustee may bring a plenary action to obtain judgment for the value of the property concealed. In this suit the finding made in the turnover proceeding is conclusive against the respondent.⁸² And the action will lie although the turnover order cannot itself be enforced because of the respondent's inability to comply.⁸³

Discharge

Both failure of the bankrupt to obtain a discharge and the grant of a discharge raise problems of res judicata peculiar to bankruptcy.⁸⁴ Section 14c

the turnover proceeding as somewhat similar to detinue and replevin, and as having some characteristics of a proceeding in rem. *Maggio v. Zeitz*, 333 U.S. 56, 63 (1948). But, as Justice Jackson recognizes in this case, while the purpose of the proceeding is to reach specific property, failure to comply with the order is punishable by contempt; while judgments in detinue and replevin are not.

79. *Maggio v. Zeitz*, *supra* note 78.

80. Assuming as I must that on August 9, 1943 [the date of the turnover order], Maggio had in his possession the goods ordered to be turned over, and even in the face of the fact that no explanation of the ultimate disposition of these goods has been given, still the record of his present condition indicates that he has no ability to comply. . . . Having come to that conclusion I believe that the opinion of the Supreme Court warrants my denying the application to punish Maggio for contempt. In fact, I feel that the opinion of the Supreme Court suggests that result.

In re Luma Camera Serv., Inc., 84 F. Supp. 839, 841 (S.D.N.Y. 1949), *on remand from Maggio v. Zeitz*, 333 U.S. 56 (1948). *Cf. In re California Motors, Inc.*, 122 F. Supp. 885 (E.D.N.Y. 1954); *In re Sussman*, 85 F. Supp. 570 (S.D.N.Y. 1949), 98 U. PA. L. REV. 584 (1950).

81. *Oriel v. Russell*, 278 U.S. 358, 366 (1929) (quoting from *In re Epstein*, 206 Fed. 568 (E.D. Pa. 1913)).

82. *Sampsell v. Gittelman*, 55 Cal. App. 2d 208, 130 P.2d 486 (Dist. Ct. App. 1942), discussed by Tobin, *A New Weapon for Enforcement of Turnover Orders Against Dishonest Bankrupts*, A5 CORP. REORG. 200 (1943). See also Tobin, *Enforcement of Turnover Order by Judgment in the State Court Against Bankrupt Where Trustee Is Unsuccessful in Enforcing the Order by Contempt Proceedings*, A5 CORP. REORG. 35 (1942).

83. See authorities cited note 82 *supra*.

84. For good general discussion, see Donnelly, *The Non-Dischargeability of Dischargeable Debts in Bankruptcy*, 36 VA. L. REV. 185 (1950), reprinted in 24 REF. J. 124 (1950).

provides seven grounds for denying a bankruptcy discharge. Under section 14c(5), discharge is barred if the bankrupt was discharged in a proceeding under the act commenced within six years prior to the current proceeding. The other six grounds involve conduct of a more or less reprehensible nature. Denial of a discharge on any one of these six grounds is *res judicata* that all provable debts scheduled in that proceeding are nondischargeable.⁸⁵ Does this principle also apply to the case where the bankrupt does not obtain a discharge because of section 14c(5), relating to a prior discharge within six years?

In considering this problem, remember that the granting of a discharge in one proceeding does not preclude a debtor from again becoming either a voluntary or involuntary bankrupt within six years, although no discharge may be granted in the second proceeding.⁸⁶ Refusal of or failure to obtain a discharge in the second proceeding because fewer than six years have elapsed does not bar a third bankruptcy; nor, if this bankruptcy occurs more than six years from the first proceeding, the granting of a discharge.⁸⁷ The discharge would clearly apply to debts incurred subsequent to the second proceeding. And, although the contrary has been espoused,⁸⁸ the better doctrine is that in such a third proceeding the bankrupt can be discharged from debts scheduled in the second proceeding.⁸⁹ Under this latter doctrine, failure to obtain, or the denial of, a discharge in the second proceeding because of section 14c(5) is not treated as an adjudication that the scheduled debts of that proceeding are nondischargeable.

So far as *res judicata* is concerned, failure to obtain a discharge is treated the same as the formal denial of a discharge.⁹⁰ Dismissal of a voluntary pro-

85. *Freshman v. Atkins*, 269 U.S. 121 (1925) (pendency of voluntary bankruptcy petition precludes consideration of a second voluntary petition in respect to the same debts); *Bluthenthal v. Jones*, 208 U.S. 64 (1908); see *Brack v. Gross*, 186 F.2d 940, 942 (4th Cir. 1951) ("The rule is generally based on the principle of *res judicata* but sometimes in cases prior to the Chandler Act, where the bankruptcy proceeding was dismissed for want of prosecution, the rule is based on the ground that otherwise a statutory requirement that an application for a discharge must be filed in a prescribed period would be frustrated.").

Only where the debt was listed in the earlier proceeding and not discharged is discharge in a subsequent proceeding barred. *In re Berkowitz*, 51 F. Supp. 80 (S.D.N.Y. 1942).

86. 1 COLLIER ¶ 14.53.

87. *Ibid.*

88. *Chopnick v. Tokatyan*, 128 F.2d 521 (2d Cir.), *cert. denied*, 317 U.S. 667 (1942).

89. *Prudential Loan & Fin. Co. v. Robarts*, 52 F.2d 918 (5th Cir. 1931), 45 HARV. L. REV. 1110 (1932); *Matter of Newman*, 48 Am. Bankr. R. (n.s.) 781 (N.D. Ohio 1942); 1 COLLIER ¶ 14.53. For other discussion, see 59 HARV. L. REV. 461 (1946).

90. *Perlman v. 322 W. Seventy-Second St. Co.*, 127 F.2d 716, 718 (2d Cir. 1942) ("a bankrupt whose estate is closed without his obtaining a discharge is in the same position as one whose discharge was denied"), 55 HARV. L. REV. 1373; *Kuntz v. Young*, 131 Fed. 719 (8th Cir. 1904); see *Freshman v. Atkins*, 269 U.S. 121 (1925).

ceeding for the bankrupt's failure to furnish indemnity or make deposit for expenses is given *res judicata* effect in the sense that debts scheduled in that proceeding are not dischargeable in a subsequent proceeding.⁹¹

When, in a subsequent bankruptcy proceeding, a creditor pleads and proves that his debt was scheduled in a prior bankruptcy of the same debtor and that, under the principles of *res judicata* just mentioned, the debt is nondischargeable, the bankruptcy court will specifically except the creditor's claim from any discharge of other debts granted in the later proceeding. If the debts listed in both proceedings are identical, the discharge may be denied altogether.⁹² But suppose the creditor, although his claim is scheduled in the subsequent proceeding, fails to plead or otherwise call the prior proceeding to the court's attention and the court grants a discharge without excepting his claim?⁹³ Since the policy underlying *res judicata* is not self-executing,⁹⁴ the *res judicata* effect of the first denial of discharge (or dismissal or failure to apply) is displaced by the second general order of discharge. The second order in turn becomes *res judicata* and bars renewal of the claim in a third action when the second discharge is properly pleaded and proved, unless the claim, under section 17, is one unaffected by a discharge.⁹⁵ Although the creditor may not collaterally attack the discharge,⁹⁶ he may move in the bankruptcy court to have the discharge amended to exclude his claim. If the motion is timely, the court

91. *Colwell v. Epstein*, 142 F.2d 138 (1st Cir.), *cert. denied*, 323 U.S. 744 (1944); *Perlman v. 322 W. Seventy-Second St. Co.*, *supra* note 90.

Presumably, the bankruptcy court could avoid *res judicata* effect by dismissing without prejudice. See 55 HARV. L. REV. 1373, 1375 (1942).

92. *In re Summer*, 107 F.2d 396 (2d Cir. 1939), *cert. denied*, 309 U.S. 680 (1940); 1 COLLIER ¶ 14.62.

When the creditor pleads *res judicata*, the bankruptcy court must consider and pass on his plea. *In re Purrier*, 73 F. Supp. 418 (W.D. Wash. 1947).

93. When both proceedings are held in the *same* court, that court, on its own motion and without the interposition of a creditor, may enter a qualified discharge if the facts come from its own records in related proceedings. *Freshman v. Atkins*, 269 U.S. 121 (1925). See also discussion in *In re Zeiler*, 18 F. Supp. 539 (S.D.N.Y. 1937). But while a court ordinarily takes judicial notice of its own records, failure to note and act upon them does not make its judgment void. "It is still the duty of one who relies on such preceding records to call the court's attention thereto, and he is not relieved therefrom because of the principle that courts take judicial notice of their records. Failure to note them in such case merely leads to an erroneous judgment in case the preceding records would require a different result. The judgment of the court in such cases, however, is not void." *Ginsberg v. Thomas*, 170 F.2d 1, 3 (10th Cir. 1948).

94. See *Treinius v. Sunshine Mining Co.*, 308 U.S. 66 (1939); *Russell v. Place*, 94 U.S. 606 (1876) (party contending that prior judgment is binding in a subsequent suit has the burden of establishing that the prerequisites for application of *res judicata* or collateral estoppel exist).

95. *Bluthenthal v. Jones*, 208 U.S. 64 (1908); *Ginsberg v. Thomas*, 170 F.2d 1 (10th Cir. 1948).

96. *Bluthenthal v. Jones*, *supra* note 95. On the general immunity of a discharge from collateral attack, see 1 COLLIER ¶ 15.02.

may grant the relief,⁹⁷ unless it finds the matter already foreclosed by general principles of res judicata.⁹⁸

Different problems attend an adjudication by the bankruptcy court or some other tribunal of a matter constituting one of the six other objections to a bankrupt's discharge—for example, commission of a bankruptcy offense, or a fraudulent transfer, or obtaining credit by a false written financial statement.⁹⁹

97. Disagreement in the cases generally centers around the time period. Reasoning that an application under § 15 for revocation of a discharge can be made only if the discharge was "obtained through fraud" and then only if the motion is filed within one year after the grant of discharge, the court in *Ginsberg v. Thomas*, 170 F.2d 1 (10th Cir. 1948), held that this section barred an application to amend the discharge made eleven years after the discharge was granted. But the Second Circuit, in *In re Seiden*, 174 F.2d 586 (2d Cir. 1949), expressly refused to follow the *Ginsberg* case, holding it proper to allow a motion to amend a discharge on the ground that dismissal of a prior voluntary proceeding in the same court was res judicata, even though the motion was filed more than eight years after the grant of discharge. See also *Harris v. Warshawsky*, 184 F.2d 660 (2d Cir. 1950), 64 HARV. L. REV. 1191 (1951), 27 N.D.L. REV. 220 (1951) (motion to amend filed more than eleven years after discharge).

98. *Brack v. Gross*, 186 F.2d 940 (4th Cir. 1951). In *Brack*, the creditor filed a claim in the bankrupt's first proceeding, which was later dismissed because of bankrupt's failure to pay the filing fee. In the bankrupt's second proceeding, the creditor again filed his claim. Without claiming that the prior proceeding made his claim nondischargeable, he opposed the bankrupt's discharge on the ground that the bankrupt had failed to keep proper books and records and had not satisfactorily explained her sources of income. This objection was overruled and a discharge granted. More than a year later he moved in the bankruptcy court to declare the discharge nugatory as to his claim on the theory that dismissal of the first proceeding rendered his claim nondischargeable. In affirming a denial of the motion, Judge Soper reasoned:

[D]ischarge of the judgment debt should have been denied in the second bankruptcy proceeding, when the judgment creditor objected to the discharge, if the point now under consideration had been raised, as it might have been, since the facts were well known to the parties. But it was not raised, and other grounds were urged for a denial of the discharge which were found insufficient by the Referee and the District Judge. The ruling constituted a formal decision that the bankrupt was entitled to a discharge and hence the question now raised in the pending case is res judicata and may not be litigated again. It is well established that the finality of a judgment covers not only all questions that were litigated in the case but all questions that might have been raised if the litigant had seen fit to do so.

Id. at 942.

99. Bankruptcy Act § 14c, 30 Stat. 550 (1898), as amended, 11 U.S.C. § 32(c) (1952), reads in part:

The court shall grant the discharge unless satisfied that the bankrupt has (1) committed an offense punishable by imprisonment as provided under title 18, United States Code, section 152; . . . or (3) obtained money or property on credit, or obtained an extension or renewal of credit, by making or publishing or causing to be made or published in any manner whatsoever, a materially false statement in writing respecting his financial condition; or (4) at any time subsequent to the first day of the twelve months immediately preceding the filing of the petition in bankruptcy, transferred, removed, destroyed, or concealed . . . any of his property, with intent to hinder, delay, or defraud his creditors; . . . *Provided*,

Under the first ground—commission of a bankruptcy offense—conviction is unnecessary to prevent discharge, proof that the bankrupt committed the offense being sufficient.¹⁰⁰ If, however, the bankrupt has been convicted, the conviction conclusively establishes an objection to the discharge made upon that ground.¹⁰¹ A judgment adverse to a creditor in an action brought by him for the bankrupt's alleged fraud in publishing a false financial statement does not bar that same creditor's objection, on the same grounds, to a discharge since the creditor's burden of proof is less in the discharge proceeding.¹⁰² If, conversely, the creditor prevails in his fraud action, then this judgment should conclude the issue of falsity and establish the creditor's subsequent objection, since the issues are presumably identical and the burden of proof in the fraud action is greater than that needed to defeat the bankrupt's right to discharge.¹⁰³

A transfer, removal, destruction, or concealment by the bankrupt of any of his property, within twelve months of bankruptcy, *with intent to hinder, delay, or defraud his creditors*, constitutes another bar to discharge.¹⁰⁴ Hence, where

That if, upon the hearing of an objection to a discharge, the objector shall show to the satisfaction of the court that there are reasonable grounds for believing that the bankrupt has committed any of the acts which, under this subdivision c, would prevent his discharge in bankruptcy, then the burden of proving that he has not committed any of such acts shall be upon the bankrupt.

100. *In re Shear*, 201 Fed. 460 (W.D.N.Y. 1913); 1 COLLIER ¶¶ 14.13, 14.17[2].

101. *In re Gophrener*, 20 F. Supp. 922 (E.D.N.Y. 1937).

On the problem of whether the bankruptcy offense must have been committed in connection with the proceeding in which the question of discharge arises, see *Raphiel v. Morris Plan Industrial Bank*, 146 F.2d 340 (2d Cir. 1944) (conviction of bankruptcy offense arising out of a prior bankruptcy proceeding does not bar discharge in a subsequent proceeding); *Schieffelin & Co. v. Herold*, 222 F.2d 262 (2d Cir. 1955) (*Raphiel* case followed); 1 COLLIER ¶ 14.17[2]; Schwartz, *Opposition to a Discharge by Reason of Acts or Conduct in Another Bankruptcy Proceeding*, 20 REF. J. 57 (1946).

102. Upon the hearing on the application of the bankrupt's discharge this judgment was improperly received in evidence. The judgment was not *res judicata* on the objections to the bankrupt's discharge. The reason for this is quite apparent. Under the laws of the State of New York in an action of this character, namely fraud, where the plaintiff seeks damages, the plaintiff must prove the material allegations of his complaint by a fair preponderance of the credible evidence and is required to show that the defendant made the representation, that it was false and that he knew or should have known that it was false, that it was material, that it was relied upon by the plaintiff, and that the plaintiff was damaged thereby. . . . [Under § 14c] an objecting creditor is not required to establish by a fair preponderance of the credible evidence his objections. All that is required is that the objector show reasonable grounds for believing that the bankrupt has committed the act charged and then the burden shifts to the bankrupt to prove that he has not committed the act so charged.

In re Kursh, 52 F. Supp. 427, 429 (E.D.N.Y. 1943). Cf. *Myers v. International Trust Co.*, 263 U.S. 64 (1923).

On the burden of proof applicable to objections, see also the proviso of § 14c quoted note 99 *supra*; 1 COLLIER ¶ 14.12.

103. Cf. authorities cited note 102 *supra*.

104. See note 99 *supra*.

the bankruptcy court sustains a creditor's objection to a bankrupt's petition for composition on its finding that the bankrupt made a transfer "with the deliberate intent to defraud his creditors," this finding conclusively supports the creditor's objection to the bankrupt's subsequent application for discharge.¹⁰⁵ Similarly, a turnover order against the bankrupt establishes that the bankrupt has property which he has improperly withheld from the trustee,¹⁰⁶ and such an order, in conjunction with a showing of fraudulent intent, supports an objection to discharge based on fraudulent concealment.¹⁰⁷

Where an involuntary petition alleges a fraudulent transfer and other acts of bankruptcy but the adjudication does not specify the act of bankruptcy upon which it is based, as already suggested, general principles of judicial finality prevent an objecting creditor from using the decree to establish a fraudulent transfer barring discharge.¹⁰⁸ Even if the decree is explicitly based on the present first act of bankruptcy, section 3a(1),—a transfer of property by the alleged bankrupt that is "fraudulent under the provisions of section 67 or 70 of this Act"—the adjudication may or may not conclusively establish a creditor's subsequent objection to discharge. The policy behind discharge, rather generally

105. *Sawyer v. Orlov*, 15 F.2d 952 (1st Cir. 1926), *cert. denied*, 274 U.S. 736 (1927).

It is irrelevant that in an action brought by the bankruptcy trustee to set aside the same transfer, a court finds that the bankrupt acted without fraudulent intent. *Ibid.*; *In re Jutkovitz*, 259 Fed. 915 (E.D.N.Y. 1919). *Contra*, *In re Parsons*, 88 F.2d 428 (2d Cir. 1937); *In re Tiffany*, 147 Fed. 314 (S.D.N.Y. 1906). The *Parsons* and *Tiffany* cases are unsupportable—at least since the amendatory act of 1926 added what is now the proviso of § 14c, see note 99 *supra*, requiring a much less onerous burden of proof to support an objection to discharge than is needed to sustain the creditor's or trustee's action to set aside a fraudulent transfer. Cf. note 102 *supra*.

106. *Maggio v. Zeitz*, 333 U.S. 56, 68 (1948). See also text accompanying notes 78-83 *supra*.

107. *In re Krall*, 196 Fed. 402 (D. Conn. 1912) ("The question at issue before him [the special master] as to concealment of assets was *res adjudicata* [having been settled in a turnover proceeding], and the record evidence made out a *prima facie* case."). Independent proof of fraudulent intent is necessary since, if bankrupt was not in bad faith in failing to turn over the property the turnover order would not establish a fraudulent concealment under § 14c(4).

Impinging on the problem is § 14c(6), which provides for denial of a discharge because of the bankrupt's refusal to obey any lawful court order. In *Southern Rock Island Plow Co. v. Florence*, 29 F.2d 397 (5th Cir. 1928), a bankrupt's noncompliance with a turnover order, when followed by the court's refusal to hold him in contempt because he was unable to comply with the order, and together with testimony at the discharge hearing that the bankrupt at the time of bankruptcy did not have the property in question, was held not to furnish a ground for denial of discharge, the court's theory being that the turnover order was unlawful. The case is unsound in light of *Maggio v. Zeitz*, *supra* note 106, which holds that a turnover order is *res judicata* on the bankrupt's possession at the time of the order, and that the order may not be collaterally attacked in the contempt proceeding even though the court may refuse to adjudge the bankrupt in contempt if it is satisfied that compliance is presently impossible. Refusal to commit for contempt in no way impairs the lawfulness of the turnover order. See notes 79-83 *supra* and accompanying text.

108. *In re Julius Bros.*, 217 Fed. 3 (2d Cir. 1914).

stated, is to relieve honest debtors from the burden of debt and to deny this relief to dishonest debtors. A transfer by a debtor made within a prescribed time of his bankruptcy with an *actual* fraudulent intent is properly a basis for the denial of a discharge. On the other hand, a transfer may, without the bankrupt's specific intent, sufficiently prejudice creditors to constitute the basis for an involuntary petition and for avoidance of the transfer by the trustee, whether the debtor is adjudged a bankrupt voluntarily or involuntarily. This is precisely the thesis of sections 3a(1), 67 and 70: although a transfer by the bankrupt with actual fraudulent intent is, of course, a "fraudulent" transfer, many other transfers clearly lacking in actual fraud are equally prejudicial to creditors and hence are "fraudulent" within the intendment of the act.¹⁰⁹ This same analysis explains the limited effect of a judgment setting aside a transfer as fraudulent, even where the court has personal jurisdiction over the bankrupt. Unless the adjudication embraces a finding of actual fraudulent intent, the judgment does not bar the bankrupt's right to discharge, for, at the very least, there must be identity of issue before denial of a discharge is coerced by a judgment of another tribunal.¹¹⁰

Who decides whether a particular claim is dischargeable? Since, under section 9, the bankrupt is entitled to protection from state civil arrest, and, under section 11(a), to a stay of in personam suits *pending at bankruptcy* when the claim upon which arrest or suit is based is dischargeable in bankruptcy,¹¹¹ this question may arise before the bankruptcy court has adjudicated the bankrupt's discharge.¹¹² If protection is sought, the bankruptcy court's determination of the dischargeability of the claim, unless reversed, is binding

109. 1 COLLIER ¶¶ 3.101, 3.105; 4 *id.* ¶¶ 67.29, 67.37, 70.71.

110. *Hayslip v. Long*, 227 F.2d 550, 554 (5th Cir. 1955).

In *Hayslip*, an action had been brought to set aside a transfer as fraudulent on three separate grounds, only one of which involved actual intent, and the jury had found generally that the conveyance was fraudulent. A creditor urged that the judgment in this action judicially established his objection to the bankrupt's discharge on the ground of a transfer with intent to hinder, delay or defraud. Holding against the creditor's contention, Judge Tuttle cautioned that the referee's decision of the bankrupt's right to a discharge "should not lightly be coerced by findings made by other tribunals"; and that the bankruptcy court and those reviewing its action should be "extremely chary in making [their] . . . decision on this matter subservient to the finding of another tribunal in an entirely different case." The court went on to rule that the prior judgment likewise failed to establish "wilful fraudulent concealment of property"—the necessary ingredient for denial of the bankrupt's homestead exemption. *Id.* at 555.

If, of course, the original proceeding involves a finding of actual fraudulent intent, this adjudication is conclusive against the bankrupt's right of discharge. *In re Skinner*, 97 Fed. 190 (N.D. Iowa 1899).

111. *In re De Lauro*, 1 F. Supp. 678 (D. Conn. 1932); 1 COLLIER ¶¶ 9.02, 9.03, 11.02-.04.

112. There are other situations in which the issue may arise prior to the grant or denial of a discharge. Although § 11a applies only to in personam suits pending against the bankrupt at the time of his bankruptcy, the bankruptcy court has power under § 2a(15) to enjoin an in personam suit against the bankrupt brought after bankruptcy. And though, unlike the situation under § 11a, the claim involved in a post-bankruptcy suit does not have to be dischargeable, dischargeability may be a factor influencing the court's

upon the parties in all other forums until the right to discharge is decided.¹¹³ Some authority exists, moreover, that a decree entered under section 9 or 11 is res judicata even after a discharge is granted.¹¹⁴ But the sound view is that this initial determination is only incidental to the administration of the act, is provisional in character and is not an ultimate decision on the merits of the dischargeability of any claim.¹¹⁵

When a discharge has been granted, questions arise concerning its effect in other proceedings and the proper court to determine this effect, for the right to a discharge and the effect of a discharge are entirely distinct matters.¹¹⁶ An order of discharge, like an adjudication of bankruptcy, is an in rem determination of status.¹¹⁷ Accordingly, it may not be collaterally attacked for

discretion. *Hisey v. Lewis-Gale Hosp.*, 27 F. Supp. 20 (W.D. Va. 1939) ; 1 COLLIER ¶ 2.62[4]. See also *Beneficial Loan Co. v. Noble*, 129 F.2d 425 (10th Cir. 1942) ; *Seaboard Small Loan Corp. v. Ottinger*, 50 F.2d 856 (4th Cir. 1931) ; note 133 *infra*.

113. *Wagner v. United States*, 104 Fed. 133 (6th Cir. 1900) ; *In re Mustin*, 165 Fed. 506 (N.D. Ala. 1903).

114. *Gorczyca v. Stanoch*, 308 Ill. App. 235, 31 N.E.2d 403 (1941) ; *Doyle v. Hollister*, 39 N.Y.S.2d 124 (N.Y. City Ct. 1942).

115. *In re De Lauro*, 1 F. Supp. 678 (D. Conn. 1932) ; see *Ciavarella v. Salituri*, 153 F.2d 343 (2d Cir. 1946) ; *Greenfield v. Tuccillo*, 129 F.2d 854 (2d Cir. 1942) ; *King v. Walsh*, 48 Ga. App. 741, 173 S.E. 435 (1934) (at least where no issue was made of whether the debt was dischargeable) ; 1 COLLIER ¶¶ 9.03, 11.04. This view is consistent with present doctrine that, once a discharge has been decreed, determination of its effect should ordinarily be committed to the nonbankruptcy court in which the claim is being presented. See note 129 *infra* and accompanying text.

116. *State Fin. Co. v. Morrow*, 216 F.2d 676 (10th Cir. 1954) ; *Harrison v. Donnelly*, 153 F.2d 588 (8th Cir. 1946) ; 1 COLLIER ¶ 14.02[4]. Since each is a separate "cause of action," under orthodox principles of res judicata, the decree of discharge is not ordinarily res judicata on questions of its effect, although factual issues adjudged in determining the right to discharge may be conclusive on the parties by operation of the doctrine of collateral estoppel. Thus, if, despite the creditor's objections, the bankrupt is discharged, the adjudication of discharge is not final on the dischargeability of the creditor's claim, unless the question of dischargeability was adjudged. *Francine v. Babayan*, 45 F. Supp. 321 (E.D.N.Y. 1942) ; *Strobl v. Zidek*, 304 Ill. App. 385, 26 N.E.2d 700, *cert. denied*, 311 U.S. 692 (1940) ; *Meier Credit Co. v. Yeo*, 129 N.J.L. 82, 28 A.2d 227 (Ct. Err. & App. 1942). See also *Stoll v. Gottlieb*, 305 U.S. 165 (1938), discussed in text at notes 35-37 *supra*. But even though the matter of dischargeability is not adjudged, as is the usual case, the parties should be held collaterally estopped from disputing relevant and material issues of fact adjudged in the discharge proceeding in any subsequent action between them. This seems to be recognized in the *Meier Credit* case.

By virtue of the Bankruptcy Act § 14, 30 Stat. 550 (1898), 11 U.S.C. § 32 (1952), which denominates the standards for granting or denying a discharge, determination of the right to discharge is a matter exclusively for the bankruptcy court having jurisdiction over the proceeding. *Armstrong v. Norris*, 247 Fed. 253, 254 (8th Cir. 1917) ("The matter of discharge in bankruptcy is essentially a constituent of the proceeding in which the adjudication and the administration of the bankrupt estate are had. It cannot be detached and taken to a court of another jurisdiction.") ; 1 COLLIER ¶ 14.02[4].

117. *Local Loan Co. v. Hunt*, 292 U.S. 234 (1934) ; *Myers v. International Trust Co.*, 263 U.S. 64 (1923), discussed in text at note 71 *supra*. Concerning the adjudication of bankruptcy, see text at notes 62, 63 *supra*.

error or irregularity in the proceedings upon which it is based,¹¹⁸ and jurisdiction to revoke the order rests exclusively with the granting bankruptcy tribunal.¹¹⁹

Though unimpeachable as a declaration of status, a decree of discharge has a limited effect as a bar to post-bankruptcy actions. The decree is general in character and silent as to the liabilities discharged.¹²⁰ It does not prevent the enforcement of a valid pre-bankruptcy lien against property even though the underlying debt, as a personal liability, has been discharged in bankruptcy.¹²¹ The general theory is that the decree does not destroy the indebtedness underlying a dischargeable claim but merely bars the personal remedy.¹²² Hence, the proper forum to determine the effect of a discharge upon a judgment and the enforcement proceedings thereunder is normally the court which rendered the judgment;¹²³ or, when the claim has not gone to judgment, the court in

118. *Bluthenthal v. Jones*, 208 U.S. 64 (1908); *General Protestant Orphans' Home v. Ivey*, 240 F.2d 239, 240 (6th Cir. 1956); 1 COLLIER ¶ 15.02.

119. *Id.* ¶ 15.03.

A claim must be provable to be dischargeable; but if provable, the claim is dischargeable whether or not it is actually proved, unless, of course, it is specifically exempted from discharge by § 17. 1 COLLIER ¶¶ 17.03, 17.04; 3 *id.* ¶¶ 63.05, 63.36. If a creditor with a provable claim files proof within the time allowed by § 57a, and the claim is allowed, the creditor is entitled to share in the bankruptcy distribution, although his claim is nondischargeable because it falls within the exceptions of § 17. *Friend v. Talcott*, 228 U.S. 27 (1913). The creditor with a nondischargeable claim need not, however, file his claim in the bankruptcy proceeding. *Personal Industrial Loan Corp. v. Forgay*, 240 F.2d 18, 20 (10th Cir. 1956), *cert. denied*, 354 U.S. 922 (1957).

120. Official Form 45 merely states that the bankrupt is "discharged from all debts and claims which are made provable by said Act against his estate, except such debts as are, by said Act, excepted from the operation of a discharge in bankruptcy." See MOORE, LAUBE & HARRIS, U.S. BANKRUPTCY ACT 449 (1956).

121. 1 COLLIER ¶ 17.29. Moreover, although our law does not provide for the conditional or suspended discharge of English and Canadian practice, the bankruptcy court may withhold the bankrupt's discharge for a reasonable time to allow a creditor's assertion of any rights he may have to pursue the bankrupt's exempt property in satisfaction of his claim. *Lockwood v. Exchange Bank*, 190 U.S. 294 (1903); 1 COLLIER ¶ 6.10, at 829-30. For other situations in which the discharge may be withheld for a reasonable time, see *Id.* ¶ 16.06.

122. *Zavelo v. Reeves*, 227 U.S. 625 (1913); *Helms v. Holmes*, 129 F.2d 263 (4th Cir. 1942).

While a discharge releases the bankrupt from legal liability to pay a dischargeable debt, the bankrupt is said to remain under a moral obligation that is sufficient to support a new promise to pay the debt; hence a new consideration is not needed to make the promise enforceable. The bankrupt's promise to pay is effectual, moreover, whether given after filing of the petition and before the discharge or after the discharge. *Zavelo v. Reeves*, *supra*. State law governs the matter of revival and whether the promise must be in writing. 1 COLLIER ¶¶ 17.33-37.

123. *Gathany v. Bishopp*, 177 F.2d 567 (4th Cir. 1949) (holding that bankrupt's defense of discharge is waived by failure to plead it as a defense in judgment creditor's proceeding to revive his judgment); *Ciavarella v. Salituri*, 153 F.2d 343 (2d Cir. 1946); *In re Devereaux*, 76 F.2d 522 (2d Cir.), *cert. denied*, 296 U.S. 589 (1935) ("[I]n general the effect of a discharge is to be raised by pleading it as a bar when the creditor attempts to enforce his claim, or using it to procure cancellation of a judgment entered before discharge, if the state statutes permit this procedure."); 1 COLLIER ¶ 17.28.

which the claim is being pursued.¹²⁴ The defense of discharge can be waived—under general doctrine, by failure to plead or otherwise properly present the issue—and the judgment is *res judicata* on claimant's right to recover.¹²⁵ Of course, if the issue is raised and tried on the merits, a final judgment is normally conclusive between the parties in all forums.¹²⁶

The bankruptcy court has power, on a creditor's application, to determine whether a particular claim is dischargeable;¹²⁷ and, if it does make such an adjudication, its judgment on the issue is *res judicata*.¹²⁸ Generally, however, bankruptcy courts refuse jurisdiction and leave the claimant to sue in any other appropriate forum, the theory being that this is an adequate remedy.¹²⁹

124. *Helms v. Holmes*, 129 F.2d 263 (4th Cir. 1942). See also *Gathany v. Bishopp*, *supra* note 123.

125. *Helms v. Holmes*, *supra* note 124; *Gathany v. Bishopp*, 177 F.2d 567 (4th Cir. 1949).

As the dissent in the *Helms* case points out, this doctrine is susceptible to abuse by an overreaching creditor pitted against a debtor who, because of his financial weakness or his belief that discharge has automatically freed him of his debt, fails to obtain adequate legal counsel. See also *Personal Industrial Loan Corp. v. Forgay*, 240 F.2d 18 (10th Cir. 1957); *General Protestant Orphans' Home v. Ivey*, 240 F.2d 239 (6th Cir. 1956); *Beneficial Loan Co. v. Noble*, 129 F.2d 425 (10th Cir. 1942).

126. *Prebyl v. Prudential Ins. Co.*, 98 F.2d 199 (8th Cir.), *cert. denied*, 305 U.S. 641 (1938). The trial court judgment is subject to appellate review, including consideration by the United States Supreme Court of both federal and state court judgments. But the remedy of appellate review is unduly burdensome in some situations. See *Local Loan Co. v. Hunt*, 292 U.S. 234 (1934); *Personal Industrial Loan Corp. v. Forgay*, 240 F.2d 18 (10th Cir. 1957).

127. *Harrison v. Donnelly*, 153 F.2d 588 (8th Cir. 1946) (upholding a judgment of discharge which excepted from its operation a claim based on a judgment for wilful and malicious injuries).

The proper exercise of this power has given the referees some concern, particularly in relation to applications by small loan companies to secure a determination that their claims are excepted from discharge. See *Persons, Discharges*, 16 REF. J. 33 (1941). For further discussion of this problem and the bankrupt's right to bankruptcy court effectuation of his discharge decree against creditor action (the *Local Loan* doctrine, see note 132 *infra*), see 5 CONF. PERS. FIN. L.Q. REP. 115 (1951); 6 *id.* at 30, 51; Friebohn, *Want To Make a Federal Case of It?*, 62 COM. L.J. 249 (1957); Smedley, *Bankruptcy Courts as Forums for Determining the Dischargeability of Debts*, 39 MINN. L. REV. 651 (1955). Much of the trouble stems from the fact that § 14c(3) authorizes denial of a discharge if the bankrupt "obtained money or property on credit, or obtained an extension or renewal of credit, by making or publishing or causing to be made or published in any manner whatsoever, a materially false statement in writing respecting his financial condition." See 1 COLLIER ¶¶ 14.34-43. But even when a bankrupt obtains a discharge, § 17a(2) prevents the discharge from releasing him from "liabilities for obtaining money or property by false pretenses or false representations." *Id.* ¶¶ 17.15, 17.16. Referee Friebohn suggests that it is "this overlapping . . . that causes the mischief. Whether used or not, it puts a club into the hands of this one class, and no other, of excepted creditors under Section 17." He sees little objection to the repeal of § 14c(3). Friebohn, *supra* at 250.

128. *Strobl v. Zidek*, 304 Ill. App. 385, 26 N.E.2d 700, *cert. denied*, 311 U.S. 692 (1940). See also *Stoll v. Gottlieb*, 305 U.S. 165 (1938), discussed in text at notes 35-37 *supra*.

129. *In re Barber*, 140 F.2d 727 (3d Cir. 1944) (holding that a creditor is not entitled as of right to have the dischargeability of his claim determined by the referee before the

Nonetheless, exceptional circumstances may arise demonstrating the inadequacy of a nonbankruptcy forum. When a particular claim is nondischargeable under section 14c(5) because of a prior bankruptcy proceeding, the bankruptcy court will, on proper application, except the claim from the operative effect of its discharge decree.¹³⁰ Unless it takes this action, the claim, if not excepted by section 17, would be discharged.¹³¹ And when, in a creditor's action to enforce a judgment or claim against the bankrupt, the debtor's remedy of litigating the effect of his discharge is inadequate, the bankruptcy court may exercise its ancillary, equitable jurisdiction to enjoin the creditor and thereby effectuate its decree of discharge.¹³²

The power is broad and continuing.¹³³ But there is a wide divergence of opinion about its proper exercise. Some courts have confined themselves very

discharge is granted); *Watts v. Ellithorpe*, 135 F.2d 1 (1st Cir. 1943); *In re Biscoe*, 45 F. Supp. 422, 423 (D. Mass. 1942) ("The usual practice is to leave the claimant if he regards his claim as undischarged to sue upon it in any appropriate forum, and to allow the discharged bankrupt there to plead his discharge. Such defence is one that the state or any other court is bound to consider, and if error is committed in failing to accord to the discharge its due weight, the way is open to the Supreme Court of the United States."); *In re Anthony*, 42 F. Supp. 312 (E.D. Ill. 1941), 28 VA. L. REV. 650 (1942).

130. See notes 92, 97, 98 *supra*.

131. See note 95 *supra*.

132. *Local Loan Co. v. Hunt*, 292 U.S. 234 (1934), approved in 23 CALIF. L. REV. 208 (1935), 29 ILL. L. REV. 520 (1934), 20 IOWA L. REV. 682 (1935), 9 U. CINN. L. REV. 314 (1935), 83 U. PA. L. REV. 92 (1934); *State Fin. Co. v. Morrow*, 216 F.2d 676 (10th Cir. 1954); *Davison-Paxon Co. v. Caldwell*, 115 F.2d 189 (5th Cir. 1940), *cert. denied*, 313 U.S. 564 (1941), 54 HARV. L. REV. 873 (1941), 39 MICH. L. REV. 812 (1941), 25 MINN. L. REV. 790 (1941), 89 U. PA. L. REV. 979 (1941); *Sims v. Jamison*, 67 F.2d 409 (9th Cir. 1933); *Seaboard Small Loan Corp. v. Ottinger*, 50 F.2d 856 (4th Cir. 1931). Compare *Gathany v. Bishopp*, 177 F.2d 567 (4th Cir. 1949) and *Helms v. Holmes*, 129 F.2d 263 (4th Cir. 1942), with *Seaboard Small Loan Corp. v. Ottinger*, *supra*. See also Glenn, *Effect of Discharge in Bankruptcy: Ancillary Jurisdiction of Federal Court*, 30 VA. L. REV. 531 (1944); *Strasburger, The Wage Assignment Problem*, 19 MINN. L. REV. 536 (1935); authorities cited note 127 *supra*.

133. *Personal Industrial Loan Corp. v. Forgay*, 240 F.2d 18, 19 (10th Cir.), *cert. denied*, 354 U.S. 922 (1957) ("This power is a continuing power and may be invoked after order of discharge and after termination of the bankruptcy proceeding The court has a continuing duty and solicitude to see that a discharged bankrupt is not unduly denied the benefits of his adjudication and discharge."); *General Protestant Orphans' Home v. Ivey*, 240 F.2d 239 (6th Cir. 1956); *State Fin. Co. v. Morrow*, *supra* note 132.

It has been held that this broad power does not warrant relitigation in the bankruptcy court of matters already decided in a nonbankruptcy suit. The nonbankruptcy judgment, including a default judgment, is therefore res judicata of the issues adjudged. Under this view, the power referred to in the text includes, primarily, bankruptcy court authority to enjoin the enforcement of a nonbankruptcy judgment obtained through extrinsic or collateral fraud. See *Beneficial Loan Co. v. Noble*, 129 F.2d 425 (10th Cir. 1942). Considerable authority exists, however, for the proposition that the bankruptcy court can override the res judicata effect of nonbankruptcy adjudications. *Holmes v. Rowe*, 97 F.2d 537 (9th Cir. 1938); see *Personal Industrial Loan Corp. v. Forgay*, *supra*; *General Protestant Orphans' Home v. Ivey*, *supra*; *State Fin. Co. v. Morrow*, *supra* note 132; *Smedley*, *supra* note 127, at 665-66.

narrowly;¹³⁴ others, using the power realistically, have vouchsafed the integrity of the discharge decree.¹³⁵ The latter seems the proper course of action. If it is not followed, an overreaching creditor too often will defeat the debtor's discharge by filing an assignment of debtor's wage claim with the employer, by garnishment proceeding, by utilizing the doctrine of *res judicata* coupled with a default judgment or judgment obtained in a small claims court, or by other means.¹³⁶ Consider the debtor of limited financial means, believing—not unnaturally—that a decree of discharge terminates his debts, and ignorant of the procedural theory that remits him to pleading the discharge defensively in the creditor's forum and appealing any adverse decision—to the Supreme Court, if necessary.¹³⁷ To say that such a debtor, or others similarly situated, usually have an adequate remedy outside the bankruptcy court is simply untrue. Of course, not all creditors are overreaching and unscrupulous; and all bankrupts are not honest and deserving. In the light of the circumstances of a particular case, the equity power of the bankruptcy court ought to be used wisely and, when its exercise is warranted, used vigorously. If it is not, the deficiency will eventually be redressed by congressional action—a less desirable method than the wise judicial use of the already existent, ample, and flexible power of equity.¹³⁸

Claims

A person may claim in a bankruptcy or reorganization proceeding the legal or equitable ownership of specific property,¹³⁹ or the right to reach part of the bankrupt's estate on some related theory;¹⁴⁰ or he may seek a distributive share in the estate as a secured or unsecured creditor.

Adjudication of a claim may have far-reaching *res judicata* effects. When a reclamation petitioner in an equity receivership fails on the merits, and the property that was the subject of the reclamation proceeding is sold by

134. *Ciavarella v. Salituri*, 153 F.2d 343, 344 (2d Cir. 1946) (the "ancillary jurisdiction is exceedingly narrow, to be exercised only 'under unusual circumstances.' . . . [S]uch jurisdiction is non-existent 'except . . . where special embarrassment arises.' "); *Helms v. Holmes*, 129 F.2d 263 (4th Cir. 1942); see also *Beneficial Loan Co. v. Noble*, *supra* note 133.

135. *Local Loan Co. v. Hunt*, 292 U.S. 234 (1934); *Personal Industrial Loan Corp. v. Forgay*, 240 F.2d 18 (10th Cir.), *cert. denied*, 354 U.S. 922 (1957); *General Protestant Orphans' Home v. Ivey*, 240 F.2d 239 (6th Cir. 1956); *State Fin. Co. v. Morrow*, 216 F.2d 676 (10th Cir. 1954); *Seaboard Small Loan Corp. v. Ottinger*, 50 F.2d 856 (4th Cir. 1942); *In re Cleapor*, 16 F. Supp. 481 (N.D. Ga. 1936).

136. For discussion of these practices, see cases cited note 135 *supra* and the dissenting opinion of Judge Paul in *Helms v. Holmes*, 129 F.2d 263, 268 (4th Cir. 1942).

137. See notes 124, 126 *supra*.

138. Cf. Referee Friebolin's vigorous objections to the Celler Bill, which would enlarge jurisdiction of the bankruptcy court to determine the effect of a discharge. *Friebolin, Want To Make a Federal Case of It?*, 62 *COM. L.J.* 249 (1957).

139. See, e.g., *In re Weisbrod & Hess Corp.*, 129 F.2d 114 (3d Cir. 1942).

140. See, e.g., cases cited note 142 *infra*.

the receiver to a vendee who subsequently becomes bankrupt, the receivership adjudication bars any attempt by the reclaimant to obtain the property from the bankruptcy trustee. The trustee is viewed as having succeeded to the property interest of the vendee, who in turn was in privity with the company originally in receivership.¹⁴¹ In much the same manner, a stockholder is so far in privity with his corporation that a trustee appointed in the stockholder's bankruptcy cannot collaterally attack a judgment against the corporation in a proceeding between the trustee and the judgment creditor involving the creditor's right to reach and apply corporate assets to the payment of his judgment.¹⁴² In other situations, the usual principles of judicial finality have been applied in determining the res judicata effect of a bankruptcy judgment which adjudicates rights in and to property: between rival claimants and their privies as to property sold by the bankruptcy court,¹⁴³ or between the trustee and an adverse claimant and their privies.¹⁴⁴

In considering creditors' claims, the bankruptcy court will not generally permit relitigation of an issue already decided by a court of competent jurisdiction.¹⁴⁵ This general rule, however, is subject to qualifications. Thus, even when a successful creditor's claim was originally opposed by the bankrupt, a creditor, or both, creditors who did not participate in the proceedings or the trustee will be permitted to dispute the issue, unless, of course, it can be shown that they are in privity with the original parties.¹⁴⁶ Consistent with general

141. *In re Weisbrod & Hess Corp.*, 129 F.2d 114 (3d Cir. 1942).

142. *Salmon v. Fitts*, 67 F.2d 681 (5th Cir. 1933); *Miller v. Ehrlich*, 36 F.2d 697 (2d Cir. 1929); cf. *Sampsell v. Imperial Paper Corp.*, 313 U.S. 215 (1941).

143. *Van Huffel v. Harkelrode*, 284 U.S. 225 (1931).

144. *Fischer v. Pauline Oil & Gas Co.*, 309 U.S. 294, 303 (1940) (judgment against trustee binding on his transferee); *United States v. New York Terminal Warehouse Co.*, 233 F.2d 238, 240 (5th Cir. 1956), discussed note 26 *supra*.

Principles related to those of res judicata have also been applied. In *First Nat'l Bank v. Luther*, 217 F.2d 262 (10th Cir. 1955), the bank sought to reclaim certain property which had been pledged to it or, alternatively, allowance of a secured claim. Its petition was rejected, the bankruptcy court allowing the bank only a general claim; and the bank acquiesced in the decision. Applying the election of inconsistent remedies doctrine, the Tenth Circuit held that the bank was precluded from asserting rights to the specific fund as the cestui of a constructive trust. See also *Kuhl v. Hayes*, 212 F.2d 37 (10th Cir. 1954).

Similarly, these related principles and the ordinary doctrines of judicial finality, see *Meinhard, Greeff & Co. v. Brown*, 199 F.2d 70, 74 (4th Cir. 1952), are generally applicable in the adjudication of creditors' claims against the estate.

145. *In re Roberts*, 213 Fed. 905 (S.D.W. Va. 1914); *In re Ulfelder Clothing Co.*, 98 Fed. 409 (N.D. Cal. 1899). See also *Heiser v. Woodruff*, 327 U.S. 726 (1946); *In re Redwine*, 53 F. Supp. 249 (N.D. Ala. 1944); *In re Chase*, 133 Fed. 79 (D. Mass. 1904).

146. *In re Brown*, 118 F.2d 198 (2d Cir. 1941); *In re Continental Engine Co.*, 234 Fed. 58 (7th Cir. 1916); *In re Ulfelder Clothing Co.*, *supra* note 145. *Contra*, *Ayres v. Cone*, 138 Fed. 778 (8th Cir. 1905).

On the general proposition that res judicata and collateral estoppel are inapplicable when identity of parties or privity is lacking, see *Mackay v. Randolph Macon Coal Co.*, 178 Fed. 881 (8th Cir. 1910); *Bridgeport-City Trust Co. v. Niles-Bement-Pond Co.*, 128 Conn. 4, 20 A.2d 91 (1941). See also note 153 *infra*.

principles of judicial finality, also, *res judicata* is inapplicable where the causes of action are different,¹⁴⁷ but the lack of identical causes of action does not prevent use of the doctrine of collateral estoppel.¹⁴⁸ Moreover, a court's denial of a deficiency judgment—not on the merits but in the exercise of a statutorily-sanctioned judicial discretion—has no *res judicata* effect as to the creditor's claim for the balance of the debt due him.¹⁴⁹

Peculiar to bankruptcy is the court's wide latitude in applying *res judicata* principles to determine whether a claim should be allowed, disallowed or subordinated. For doctrines are always subject to the paramount equitable powers of bankruptcy courts to prevent the perpetration of fraud and collusion, and to deal justly between the judgment creditor and other claimants.¹⁵⁰

It has been stated that the "allowance or disallowance of a claim in bankruptcy should be given like effect as any other judgment of a competent court, in a subsequent suit against the bankrupt or any one in privity with him."¹⁵¹ Thus, the final allowance of a claim is a finding that the claim against the bankrupt exists and that it has not been discharged or waived.¹⁵² This adjudication is binding upon the parties in interest and their privies¹⁵³ and cannot be col-

147. *Friend v. Talcott*, 228 U.S. 27 (1913), discussed note 163 *infra*; *Meinhard, Greeff & Co. v. Brown*, 199 F.2d 70 (4th Cir. 1952).

148. Although *res judicata* does not apply where the causes of action are different, a material issue that is adjudged in one cause of action is conclusively settled between the parties in litigation involving a different cause of action. See the discussion of *Myers v. International Trust Co.*, 263 U.S. 64 (1923), in text at notes 71-75 *supra*. Cf. *Friend v. Talcott*, *supra* note 147 (no judicial finality as to an unadjudged issue).

149. *Langford v. Bond Realty Corp.*, 47 F.2d 480 (5th Cir. 1931) (denial of deficiency decree did not, under Florida law, bar suit at law on the notes).

150. *Pepper v. Litton*, 308 U.S. 295 (1939); cf. *Heiser v. Woodruff*, 327 U.S. 726 (1946).

151. *United States v. American Sur. Co.*, 56 F.2d 734, 736 (2d Cir. 1932); *accord*, *United States v. Coast Wineries, Inc.*, 131 F.2d 643 (9th Cir. 1942).

152. *Gleason v. Thaw*, 234 Fed. 570, 575 (2d Cir. 1916), *cert. denied*, 243 U.S. 656 (1917).

153. *Wallingsford v. Larson Co.*, 237 F.2d 904 (8th Cir. 1956) (holding that co-maker with bankrupt of a note, who opposed allowance of the claim on the note in the bankruptcy proceeding on grounds of payment, is precluded by the bankruptcy court's allowance of the claim from disputing, in a subsequent suit for the balance due on the note, that the note was unpaid); *In re Long Island Properties, Inc.*, 143 F.2d 349 (2d Cir. 1944) (allowance of a secured claim based on a mechanic's lien fixes the status thereof; hence the claim's validity is not affected by the lienor's subsequent failure to refile within the time specified by state law); *Clinton v. Shoop*, 118 F.2d 811 (8th Cir. 1941) (where certain claims filed as secured claims were allowed only as general unsecured claims, the alleged securities having been held void, the claimant's successor in title is bound by that order of the bankruptcy court; he therefore has no right to institute a later suit in a state tribunal to enforce his alleged securities); *Edwin Clapp & Son, Inc. v. Knorr*, 106 Kan. 733, 189 Pac. 936 (1920) (since allowance is an adjudication as to the person of the debtor, a creditor may not shift his position and subsequently allege that the bankrupt was only his agent).

Allowance of a claim, however, does not bar state court action where an involuntary petition was filed while the state court judgment was already on appeal, even though

laterally attacked in another proceeding.¹⁵⁴ As a general rule, application of the doctrine of judicial finality depends on a showing either that the matter controverted in the second action was raised and litigated in the proceeding for allowance, or that the matter, if not raised, was one which could and should have been brought forward and tried.¹⁵⁵ The referee's order of allowance or disallowance, if not reviewed within the time and manner provided by the act, has the same force and effect as a judgment of the district judge.¹⁵⁶

In connection with the allowance of a creditor's claim, two related problems should be noted. These concern the effect of the referee's allowance of a claim, first, upon the statute of limitations and, second, upon a subsequent tort suit by a creditor who originally proved his right to recover on a contractual or quasi contractual theory.

Under the Bankruptcy Act prior to 1938, allowance of a claim against the

further proceedings were stayed until discharge. *Tutt v. Fighting Wolf Mining Co.*, 209 S.W. 304 (Mo. Ct. App. 1919). Nor does allowance preclude the creditor from resorting to concurrent means of enforcement. *Kolakowski v. Cyman*, 285 Mich. 585, 281 N.W. 332 (1938).

Unless reconsideration is granted, allowance of a claim the proof of which clearly discloses that it constitutes the balance remaining after a setoff is *res judicata* as to the creditor's right to set off his debt against his claim. *In re Empire Flooring Co.*, 43 F.2d 748 (W.D. Pa. 1930). But when bankruptcy proceedings are concluded without the right of setoff under § 68 having been asserted, there is no bankruptcy court judgment on the issue which can be pleaded as *res judicata*. *Cumberland Glass Mfg. Co. v. DeWitt*, 237 U.S. 447 (1915).

As between all creditors, allowance, subject to bankruptcy court reconsideration of the claim, is a binding adjudication that the claim existed against the estate and was allowed. *Gleason v. Thaw*, *supra* note 152. But allowance of a claim does not normally conclude the issues adjudicated in independent litigation between the creditors themselves. *Bridgeport-City Trust Co. v. Niles-Bement-Pond Co.*, 128 Conn. 4, 20 A.2d 91 (1941). To this general rule there are exceptions—for example, where allowance was opposed in the bankruptcy proceeding by the other creditor, *Wallingsford v. Larson Co.*, *supra*, or where, for an appropriate reason, the creditor against whom the allowance is invoked is precluded from shifting his position, *Edwin Clapp & Son, Inc. v. Knorr*, *supra*.

For cases illustrating the binding effect of an allowance of claim against the bankrupt, see *Blanks v. West Point Wholesale Grocery Co.*, 225 Ala. 74, 142 So. 49 (1932); *Elmore, Quillian & Co. v. Henderson-M. Merc. Co.*, 179 Ala. 548, 60 So. 820 (1913). But see *Mussman & Riesenfeld, Jurisdiction in Bankruptcy*, 13 LAW & CONTEMP. PROB. 88, 92-93 (1948). For the right of the bankrupt or his privy to the benefit of a *disallowance* on the merits, see note 166 *infra*.

154. *Clinton v. Shopp*, *supra* note 153; *Gleason v. Thaw*, 234 Fed. 570, 575 (2d Cir. 1916).

155. *Meinhard, Greeff & Co. v. Brown*, 199 F.2d 70, 74 (4th Cir. 1952) ("The allowance of a claim in bankruptcy operates ordinarily to estop the claimant as to all matters which were or should have been included in the claim, but not as to matters which could not have been included."); *Stearns Salt & Lumber Co. v. Hammond*, 217 Fed. 559 (6th Cir. 1914); *Buder v. Columbia Distilling Co.*, 96 Mo. App. 558, 70 S.W. 508 (1902); *Clendening v. Red River Valley Nat'l Bank*, 12 N.D. 51, 94 N.W. 901 (1903).

156. *Stearns Salt & Lumber Co. v. Hammond*, *supra* note 155; *Maryland Cas. Co. v. United States*, 91 Ct. Cl. 203, 32 F. Supp. 746 (1940); *Clendening v. Red River Valley Nat'l Bank*, *supra* note 155.

bankrupt estate did not toll the running of a statute of limitations against the creditor's same claim asserted out of bankruptcy. In other words, the allowance did not engender, for nonbankruptcy purposes, a new and independent statute of limitations. Even when the bankrupt was not discharged and the creditor sought to pursue the balance of his claim through legal proceedings, therefore, expiration of the statute was a good defense; for the creditor could not assert that the bankruptcy proceeding had suspended the running of the statute.¹⁵⁷ The Bankruptcy Act of 1938 has not changed the rule that an order of allowance is not a judgment against the bankrupt necessitating the beginning of a new limitation period. But section 11f of the act suspends the operation of any federal or state statute of limitations affecting provable debts from the time the petition in bankruptcy is filed until one of the three situations specified in the section occurs.¹⁵⁸

Concerning tort recovery after allowance of a claim in contract, one should bear in mind that, until 1938, a nonjudgment claim "arising out of a pure tort which neither constitutes a breach of an express contract nor results in any unjust enrichment of the tortfeasor that may form the basis of an implied contract" was not provable in bankruptcy.¹⁵⁹ Since 1938, the right to recover damages in an action for negligence, if the action is pending when the bankruptcy petition is filed, has been recognized as a provable claim under section 63a(7). But with this exception, a "pure" tort claim, not reduced to judgment before bankruptcy, remains nonprovable in bankruptcy and hence is not dischargeable under section 17.¹⁶⁰ The creditor may have a claim, as for breach of a false warranty, which would support either an action in tort or an action in contract, or he may have an election to proceed either in tort or in quasi-contract, as in a conversion claim. In these and analogous situations, courts have held that the claims are to be considered provable under section 63a(4)¹⁶¹ and hence dischargeable unless they come within one of the exceptions to section 17.¹⁶² Since the creditor has no choice but to treat such a claim as provable, the fact that he proves a "contract" claim will not prevent him from there-

157. 1 COLLIER ¶ 11.14; 3 *id.* ¶ 57.14.

158. 1 *id.* ¶ 11.14.

159. *Schall v. Camors*, 251 U.S. 239, 248 (1920), 20 COLUM. L. REV. 481, 15 ILL. L. REV. 220, 18 MICH. L. REV. 326, 29 YALE L.J. 455.

160. 3 COLLIER ¶ 63.25. Provability in reorganization and arrangement proceedings is not limited to those claims made provable in bankruptcy under § 63. See, *e.g.*, § 106(1) of ch. X, Corporate Reorganizations, 52 Stat. 883 (1938), as amended, 11 U.S.C. § 506 (1952); § 307 of ch. XI, Arrangements, 52 Stat. 906 (1938), as amended, 11 U.S.C. § 707 (1952). Under chapter XI, however, debts which are nondischargeable under § 17 are not discharged by the confirmation of an arrangement—though § 17 does not limit the dischargeability of claims in corporate reorganization. Bankruptcy Act § 228, 52 Stat. 899 (1938), as amended, 11 U.S.C. § 628 (1952).

161. *Frederic L. Grant Shoe Co. v. W. M. Laird*, 212 U.S. 445 (1909) (breach of warranty); *Tindle v. Birkett*, 205 U.S. 183 (1907) (goods sold and delivered on the basis of false representations); *Crawford v. Burke*, 195 U.S. 176 (1904) (conversion).

162. *Tindle v. Birkett*, *supra* note 161; *Crawford v. Burke*, *supra* note 161.

after bringing a tort action against the bankrupt on the underlying transaction. He can avoid the effect of the general bankruptcy discharge by showing that his claim was excepted under section 17.¹⁶³

When the bankruptcy court disallows a claim, the *res judicata* or collateral estoppel effect of its action must be carefully limited to the true meaning of the order.¹⁶⁴ Thus, it is often said that a disallowance because the debt is not provable in bankruptcy "decides nothing as to merits of the claim."¹⁶⁵ On the other hand, if the claim is disallowed because invalid, the bankruptcy adjudication concludes the creditor in a subsequent suit against the bankrupt or his privy.¹⁶⁶

The allowance or disallowance of a claim presented by a creditor who may have received a transfer voidable under the act raises special problems both of *res judicata* and summary jurisdiction. Section 57g of the Bankruptcy Act provides:

g. The claims of creditors who have received or acquired preferences, liens, conveyances, transfers, assignments or encumbrances, void or voidable under this title, shall not be allowed unless such creditors shall surrender such preferences, liens, conveyances, transfers, assignments, or encumbrances.¹⁶⁷

Under the general view, if the trustee does not defend against the creditor's claim on a ground stated in section 57g, allowance of the claim is not *res judicata* on the question of the illegal transfer; the trustee can therefore later

163. *Friend v. Talcott*, 228 U.S. 27 (1913), holds that the identity of cause prerequisite to the application of *res judicata* does not exist between the granting of a general discharge in bankruptcy and an action for the balance of a debt excepted by the act from operation of the discharge. Hence, the discharge is not *res judicata* of the creditor's right to sue in tort for the balance of his claim. Moreover, proof of claim on a contract or quasi contract basis and receipt of a dividend does not constitute an election or waiver of the creditor's right to pursue the balance if it is the type of claim excepted from discharge under § 17.

164. *Lubbock Nat'l Bank v. Elkins*, 47 F.2d 106 (5th Cir. 1931) (disallowance of a claim as secured because of fraudulent alteration in a securing deed is not *res judicata* as to another valid security for the same claim); *Georgia Sec. Co. v. Arnold*, 56 Ga. App. 532, 193 S.E. 366 (1937) (disallowance for belated filing of proof is not an adjudication on the merits). See also note 214 *infra*.

If, after an appeal from the referee's order of disallowance, the district judge permits withdrawal of the claim, the referee's disallowance is not *res judicata* in a state court action against a guarantor. *Vander Meer v. Weurding*, 227 Mich. 46, 198 N.W. 828 (1924).

165. *United States v. American Sur. Co.*, 56 F.2d 734, 736 (2d Cir. 1932).

166. *Lesser v. Gray*, 236 U.S. 70 (1915); *United States v. Coast Wineries, Inc.*, 131 F.2d 643 (9th Cir. 1942) (holding that adjudication disallowing claim as invalid binds the United States, when it is the creditor claimant); *Hargadine-McKittrick Dry Goods Co. v. Hudson*, 122 Fed. 232 (8th Cir. 1903) (disallowance of claim because of statute of limitations bars subsequent suit against bankrupt); *Maryland Cas. Co. v. United States*, 91 Ct. Cl. 203, 32 F. Supp. 746 (1940) (holding that a referee's decision against allowing a government tax claim based on his finding that the bankrupt did not owe the tax—if not appealed from—is conclusive against the government in a subsequent action by a surety for the bankrupt, to recover the amount of the tax claim he has paid); *cf. Mussman & Riesenfeld*, *supra* note 153, at 88, 92-93.

167. 30 Stat. 560 (1898), as amended, 11 U.S.C. § 93 (1952).

bring suit against the creditor to recover the alleged voidable preference or other transfer.¹⁶⁸ When, however, the trustee does interpose a section 57g defense and the issue is decided against him, allowance of the claim bars his subsequent action to recover on the theory of a voidable transfer.¹⁶⁹ For similar reasons, a decision in the trustee's favor on a section 57g defense concludes the issue against the creditor in a later plenary action brought by the trustee to recover the money or property preferentially or fraudulently transferred.¹⁷⁰

Complicating determination of these res judicata effects is the intruding problem of summary jurisdiction. A creditor can always consent to a bankruptcy court's exercise of summary jurisdiction; and the Bankruptcy Act, under certain circumstances, gives a bankruptcy tribunal summary jurisdiction in cases of nonconsent.¹⁷¹ Clearly, the bankruptcy court has summary jurisdiction to allow or disallow claims and, therefore, to determine whether a creditor has a provable claim, whether the claim has merit and, if so, its amount. But has the creditor, by filing his claim, consented to the adjudication of a section 57g issue? And, if not, does section 57g or any other provision nevertheless warrant the bankruptcy court's summary determination of that issue? Finally, if it has summary jurisdiction, may the bankruptcy court grant the trustee an affirmative judgment of recovery?

Divergent answers have been given by the courts. The judicial uncertainty is best illustrated by the discussion and holding of *Inter-State National Bank*

168.

But if the trustee does not plead the defence, the allowance of the claim is not res judicata upon the issue of preference, and could not be without confusion of the doctrine of merger with that of estoppel. The allowance, like a judgment, is indeed an effective bar to any subsequent objection to the claim; but it establishes no fact by way of estoppel which was not decided, and necessarily decided. When the trustee does not plead the defence the issue cannot be decided; and he may therefore later assert any claim depending upon it. Such decisions as have passed upon the point are in accord with this view.

Bloch v. Mill Factors Corp., 119 F.2d 536, 538 (2d Cir. 1941); *accord*, *Buder v. Columbia Distilling Co.*, 96 Mo. App. 558, 70 S.W. 508 (1902).

It might, however, be argued that the trustee is obligated to raise the § 57g issue and that, under usual principles of res judicata, he should be concluded with respect to all grounds that could have been put forth by him. This view would not necessarily subject the bankrupt estate to undue risk of ex parte allowance; but it would often require the trustee to seek reconsideration of the allowance on the basis of § 57g. If reconsideration were granted—and a liberal court attitude toward petitions for reconsideration would be necessary to protect the estate—the trustee could then interpose the § 57g issue, and, under the better view, could counterclaim for an affirmative recovery in the bankruptcy court.

169. *Clendenen v. Red River Valley Nat'l Bank*, 12 N.D. 51, 94 N.W. 901 (1903); see *Bloch v. Mill Factors Corp.*, 119 F.2d 536, 538 (2d Cir. 1941).

170. *Giffin v. Vought*, 175 F.2d 186 (2d Cir. 1949); *Schwartz v. Levine & Malin, Inc.*, 111 F.2d 81 (2d Cir. 1940); *Breit v. Moore*, 220 Fed. 97 (9th Cir. 1915); *Feiring v. Gano*, 114 Colo. 567, 168 P.2d 901 (1946); *Woods v. Rapoport*, 128 Wash. 140, 222 Pac. 220 (1924); see *Metz v. Knobel*, 21 F.2d 317 (2d Cir. 1927).

171. See 5 MOORE, FEDERAL PRACTICE ¶ 38.30[3] (2d ed. 1948).

v. Luther.¹⁷² The bank filed its claim on an unsecured note for \$50,000. The trustee admitted the merits of the claim, but defended against its allowance on the ground that the creditor had received voidable preferences through the payment to it of one promissory note for \$100,000 and another for \$50,000; the trustee also interposed a counterclaim, which he denominated an "action to recover," alleging the voidable preferential payments, and prayed "for an order requiring the claimant Bank to pay into court the sum of \$151,180.55 (principal and interest), and that in such event, the Bank's claim be allowed as a common claim in the amount of \$50,000.00, plus interest." He thus sought to defend against allowance of the bank's claim on, and to obtain affirmative recovery of, the voidable preferential payments. The bank clearly and expressly objected to summary jurisdiction over the counterclaim. The referee, overruling the objection, held that a creditor who files a proof of claim invokes the jurisdiction of the court and consents to the adjudication of all proper defenses, setoffs and counterclaims which the trustee may lawfully interpose. After hearing, the referee found for the trustee on the merits, offset the claim for the unpaid \$50,000 note against the voided preference, and decreed that the trustee recover from the bank the difference of \$100,333.33. "On petition to review, the trial court affirmed the referee on jurisdiction and facts, but, denying the setoff against the preference, it rendered judgment against the Bank for the full amount of the preference in the sum of \$150,875.00 (principal plus interest from date of preference) with interest thereon from the date of the filing of the action to recover; and ordered that the Bank's claim be allowed as a common claim only after payment of the preference."¹⁷³

In affirming the trial court, Judge Murrah stated for the Tenth Circuit:

Everyone apparently concedes, as they must, that the bankruptcy court is without summary jurisdiction to adjudicate a controversy respecting property or chose in action held adversely to the bankrupt estate without the consent of the adverse claimant. . . . The narrow and perplexing question here is whether the entry of the Bank's appearance in the bankruptcy proceedings and the filing of its claim constituted requisite consent to the exercise of summary jurisdiction to adjudicate a preference and grant affirmative relief thereon.¹⁷⁴

He proceeded to discuss three lines of authority, each espousing a different solution for the problem. First, he said:

On the question of conferrable summary jurisdiction by an appearance and the filing of a claim, there is respectable authority for denying sum-

172. 221 F.2d 382 (10th Cir.), *cert. granted*, 350 U.S. 810 (1955), *cert. dismissed by stipulation of parties*, 350 U.S. 944 (1956).

173. 221 F.2d at 386.

174. *Id.* at 386-87. Judge Murrah described the trustee's affirmative pleadings as "... in substance and effect an equitable counterclaim for an adjudication of a preference and a judgment for recovery of the same, the mode of procedure for which is governed by the Federal Rules . . . particularly Rule 13. See General Order of Bankruptcy Number 37" *Id.* at 387.

mary jurisdiction to adjudicate a preference or to grant any affirmative relief on a counterclaim to a general claim filed in the proceedings. It is said that although a preference is a valid defense which the trustee may interpose to a claim, the bankruptcy court is without summary jurisdiction to hear and determine such defense, but can go no further than to determine the net amount of the claim and hold the same in abeyance until the preference issue has been adjudicated in a plenary suit, unless of course the filing claimant acquiesces in the exercise of summary jurisdiction over the counterclaim for preference. . . .¹⁷⁵

He went on to discuss a second approach to the problem:

Other courts have sustained summary jurisdiction to adjudicate a preference on a counterclaim, but denied any such jurisdiction to grant affirmative relief. . . . The courts sustaining defensive summary jurisdiction do so on the theory that it is a necessary incident to the power to determine allowability. . . . And, the question of preference having been thus adjudicated, it is res judicata in the plenary action for affirmative relief thereon. . . .¹⁷⁶

Under the third line of authority outlined by Judge Murrah, the bankruptcy court's summary jurisdiction is broad enough to encompass the rendering of an affirmative judgment in favor of the trustee and against the creditor when complete relief is warranted. Thus, no plenary action by the trustee is necessary for the recovery of the preferential or fraudulent property which the creditor has received. Adopting this solution as his own, the judge went on to treat the case at hand:

The Bank earnestly contends, however, that in no event does the court have jurisdiction of a counterclaim for a preference which did not arise out of the same transaction giving rise to the claim. And, it is said that the notes forming the basis for the counterclaim are separate and distinct transactions from the note on which the claim is based. Section 68, sub. a . . . authorizes the setoff of all mutual debts or credits between the estate of a bankrupt and a creditor, and provides that the account shall be stated and one debt set off against the other; and that only the balance shall be allowed and paid. This Section of the Act does no more than import the time-honored doctrine of equitable setoff into the bankruptcy law. . . . The referee set off the claim against the counterclaim, stated the account and gave judgment in favor of the trustee for the balance.

And while Section 68 does not purport to confer jurisdiction not otherwise existing, Section 68, sub. a does authorize the court to balance the accounts between a creditor and the bankrupt estate based upon mutual debts or credits. . . . Section 68, sub. b, however, prohibits the allowance of a setoff in favor of a debtor who obtains a preference under Section 57, sub. g, and it was manifestly for that reason the trial court denied the setoff allowed by the referee. Section 68 does not specifically provide for a counterclaim. It is silent with respect thereto beyond the negative provision that they shall not be allowed in favor of a debtor under specified conditions. . . . But Section 68 was not intended to govern jurisdiction or to provide a mode of procedure. The Federal Rules of Civil Pro-

175. *Id.* at 388.

176. *Ibid.*

cedure are expressly made applicable and we look to Rule 13 to determine whether the counterclaim is maintainable.

Counterclaim under Rule 13, F.R.C.P., includes both setoff and recoupment, and is broader than either in that it includes other claims and may be used as a basis for affirmative relief. . . . The only difference in the two sub-sections [(a) and (b)] which we need to note is that the compulsory counterclaim, being ancillary to the claim, derives its jurisdiction from the same source, whereas a permissive counterclaim not arising out of the same transaction or occurrence must rest upon independent grounds of jurisdiction. But even that distinction is of no consequence here for concededly the counterclaim is within the conferrable jurisdiction of the parties. And, being of the view that the Bank impliedly consented to the jurisdiction of the court, the counterclaim was maintainable under Rule 13(b), F.R.C.P., whether compulsory or permissible. . . .

We hold, therefore, that the court acquired jurisdiction of the counterclaim by implied consent, and that it was authorized to adjudicate the preference and give judgment for recovery of the same.

To the contention that the Bank was denied the right to a jury trial, it need only be said that if, as we have held, the Bank impliedly consented to the summary jurisdiction of the court, it thereby pro tanto waived its right to a jury trial on the issues involved in the claim and counterclaim, including the preference issue.¹⁷⁷

In dissent, Judge Phillips subscribed to the first line of authority noted by Judge Murrah. He thus preferred a solution which precluded adjudication of voidability by the bankruptcy court, and hence the collateral estoppel consequences of such an adjudication, in the plenary action which the trustee would have to bring.¹⁷⁸

177. *Id.* at 389-90.

178. Judge Phillips, dissenting, in part argued:

It should be kept in mind that a voidable preference arises only if a transfer is made under the condition laid down in [§ 60 of the Bankruptcy Act] . . . and bankruptcy ensues within four months thereafter. It is not a cause of action or a defense which existed in the bankrupt prior to bankruptcy, but is a cause of action or a defense inuring only to the trustee.

Moreover, with respect to the claim of a creditor who has received a voidable preference, it is not ordinarily a defense to a claim per se. Rather, it merely precludes the allowance of a valid and enforceable claim until the preference has been surrendered. It is a condition precedent to allowance and not a defense to the claim per se.

There can be no doubt that a creditor who has received a voidable preference may not have a general claim allowed until he has surrendered such preference.

. . . .
It is my conclusion that where a creditor has filed a general claim and the trustee asserts that such creditor has received a voidable preference, which he has not surrendered and which precludes the allowance of the claim, and where the general claim and the alleged voidable preference arise out of separate and distinct transactions [as Judge Phillips believed they did in this case], and the alleged voidable preference does not constitute a defense per se to the claim, but merely creates a condition which must be fulfilled before the claim is allowed, the filing of the general claim does not constitute a consent to the adjudication of the voidable

It seems clear that the second line of authority and manner of dealing with the problem, as mentioned in Judge Murrah's opinion, is not sound. Under this approach, the bankruptcy court adjudicates the issue of voidability; but, even when the transfer has been found invalid, the court does not render an affirmative judgment in favor of the trustee. He is therefore remitted to a plenary suit in order to obtain the money or other property involved.¹⁷⁹ Since, in the plenary suit, all or substantially all of the material issues are concluded under the doctrine of collateral estoppel by the previous bankruptcy adjudication,¹⁸⁰ the plenary suit becomes largely a formal matter, burdensome for the trustee and affording little protection to the transferee.¹⁸¹

Either the first or third resolution of the problem, as espoused by Judge Phillips and Murrah respectively, represents a more practical approach. The first requires a plenary suit, but the issues of voidability are actually open to litigation in that suit. Under the third, the bankruptcy court adjudicates all issues—those concerning the creditor's claim and those pertaining to the creditor's alleged receipt of a voidable preference or fraudulent transfer; if these issues are decided in favor of the trustee, the bankruptcy tribunal proceeds to render an affirmative judgment.

This third solution—the one adopted by the majority in the *Inter-State Bank* case—seems the better one for several reasons. In the first place, it gives full expression to the *Alexander v. Hillman* doctrine that equity, once invoked,

preference by the referee in the exercise of his summary jurisdiction; and that the proper procedure in such cases is for the referee to inquire as to whether the adverse claim is merely colorable or whether it is really adverse, substantial, and asserted in good faith, and that if the referee finds the latter, he should stay the proceedings on the claim and direct the trustee to file a plenary suit to recover the alleged unlawful preference. Such a procedure would protect the bankrupt estate and at the same time accord the adverse claimant his right to a trial by jury in appropriate cases, his statutory right to have the suit brought and tried in the proper venue, and his right to have the action tried, agreeable to the ordinary processes of a plenary action. . . . To hold otherwise would require a general creditor with a valid general claim to choose between foregoing his general claim or waiving his right to have his adverse claim adjudicated under the ordinary processes of a plenary suit, in a proper venue and with a right to a jury trial, where appropriate, rather than in a summary bankruptcy hearing.

Id. at 398, 401.

179. See text at note 176 *supra*. See also note 170 *supra*.

180. See cases cited note 170 *supra*. Compare *Schwartz v. Levine & Malin, Inc.*, 111 F.2d 81 (2d Cir. 1940) (to the effect that the adjudication necessarily includes the amount of the preference received, as well as its voidability), with *Feiring v. Gano*, 114 Colo. 567, 168 P.2d 901 (1946) (the adjudication is not conclusive as to the amount fraudulently or preferentially transferred to the creditor).

181. See, e.g., *Schwartz v. Levine & Malin, Inc.*, *supra* note 180 (trustee granted summary judgment); *Breit v. Moore*, 220 Fed. 97 (9th Cir. 1915) (trustee granted judgment on the pleadings). See also *Giffin v. Vought*, 175 F.2d 186, 190 (2d Cir. 1949). Even under the unsound limiting doctrine of *Feiring v. Gano*, *supra* note 180, the heart of the matter—voidability—stands adjudicated. For criticism of the *Feiring* case, see Gee, *A Persistent Conflict Revived Over Collateral Attack Upon Disallowance of a Claim by a Referee in Bankruptcy*, 26 ORE. L. REV. 188 (1947).

will achieve complete relief.¹⁸² Even apart from that doctrine, however, a sound construction of the Bankruptcy Act warrants complete adjudication. The act distinctly gives the bankruptcy court summary jurisdiction to allow or disallow claims; and section 57g further decrees that the claims of creditors who have received voidable preferences or other transfers "shall not be allowed unless such creditors shall surrender such preferences, liens, conveyances, transfers, assignments, or encumbrances." As an incident of its power to disallow claims, the bankruptcy court thus has jurisdiction to determine a section 57g issue raised by the trustee and, by the same reasoning, to entertain a counterclaim recognized by section 68, authorized by Federal Rule 13, and based on the 57g issue. Should the matter be decided favorably for the trustee, the bankruptcy court is entitled to render an affirmative judgment on the counterclaim. Only such a judgment provides the complete relief which a court of equity—and the bankruptcy court sits as a court of equity¹⁸³—normally awards when it assumes jurisdiction.¹⁸⁴ Moreover, the realities of litigation necessitate complete relief, for the collateral estoppel effect of the resolution of the 57g issue leaves few if any substantial issues open for adjudication if a plenary suit be required. Possible hardships to the creditor mentioned in the dissenting opinion in *Inter-State Bank*—his forced submission to summary jurisdiction whenever the trustee has a counterclaim, his loss of jury trial in some instances—¹⁸⁵ should not lead to a rule generally denying affirmative jurisdiction. Rather, when the objections to summary jurisdiction in a particular case are sufficiently impelling, the bankruptcy court, as a court of equity and in the exercise of a sound discretion, should stay its hand and remit the trustee to a plenary suit.¹⁸⁶

182. 296 U.S. 222 (1935) (holding that in an equity receivership proceeding, creditors, by filing claim to shares in the distribution of the receivership res, submit themselves to the receiver's counterclaims asserting their liability to the estate, equity, having jurisdiction, will give complete relief). See also *Taylor v. Producers Pipe & Supply Co.*, 114 F.2d 785 (10th Cir. 1940).

Reclamation proceedings should be distinguished from those involving ordinary claims. A reclamation petitioner seeks not a distributive share of the bankrupt estate, but the return of specific property allegedly belonging to him. In such a proceeding, the claimant clearly submits to a summary adjudication of his rights; and the court may, upon a proper counterclaim by the trustee, determine all the rights of the petitioner and trustee with respect to the property. *Floro Realty & Inv. Co. v. Steem Elec. Corp.*, 128 F.2d 338 (8th Cir. 1942). But *Daniel v. Guaranty Trust Co.*, 285 U.S. 154 (1932), held that the claimant does not by his petition consent to the bankruptcy court's summary adjudication of his liability with respect to totally unrelated matters introduced in a trustee's counterclaim. This case is not in conflict with *Alexander v. Hillman*; in *Guaranty*, the claimant was not seeking a distributive share of the bankrupt estate, as a creditor filing a claim in bankruptcy does, and as the petitioners in *Alexander v. Hillman* did when they sought a distributive share of the receivership res.

183. *Pepper v. Litton*, 308 U.S. 295 (1939).

184. *Alexander v. Hillman*, 296 U.S. 222 (1935).

185. See note 178 *supra*.

186. See *Kleid v. Ruthbell Coal Co.*, 131 F.2d 372 (2d Cir. 1942) (referee, in his discretion, could allow creditor to withdraw his claim prior to the hearing on the trustee's

THE EFFECT IN BANKRUPTCY PROCEEDINGS OF JUDGMENTS RENDERED
BY OTHER COURTS

In determining the effect to be given in bankruptcy proceedings to judgments rendered by other forums, the bankruptcy court recognizes and applies the basic principles of *res judicata*¹⁸⁷ and full faith and credit.¹⁸⁸ With respect

§ 57g objections, on the condition that the creditor would submit to the jurisdiction of the district court in a plenary suit to determine the validity of the alleged preference); *cf.* *Thompson v. Magnolia Petroleum Co.*, 309 U.S. 478 (1940) (title to property over which the bankruptcy court had summary jurisdiction could be determined in a state court plenary suit). See also 5 MOORE, *FEDERAL PRACTICE* ¶ 38.30[2] (2d ed. 1948), discussing bankruptcy court authorization for liquidation of a claim outside the bankruptcy court—given in the interest of a jury trial. Many of the reasons that support the granting of affirmative relief in § 57g cases likewise suggest the propriety, in most situations, of full bankruptcy court relief against creditors in proceedings concerning recoupment or setoff, even when § 57g is not involved. *In re Solar Mfg. Corp.*, 200 F.2d 327 (3d Cir. 1952), *cert. denied sub nom.* *Marine Midland Trust Co. v. McGirl*, 345 U.S. 940 (1953); *Columbia Foundry Co. v. Lochner*, 179 F.2d 630 (4th Cir. 1950); *Flourance v. Kresge*, 93 F.2d 784 (4th Cir. 1938); see *Conway v. Union Bank*, 204 F.2d 603 (2d Cir. 1953); *Chase Nat'l Bank v. Lyford*, 147 F.2d 273, 277 (2d Cir. 1945); *cf.* *Harlow Realty Co. v. Whiting*, 308 Mass. 220, 31 N.E.2d 928 (1941). Compare *In re Greenstreet, Inc.*, 209 F.2d 660 (7th Cir. 1954) (holding that, absent statutory consent, an affirmative judgment cannot be rendered against the United States).

In the more extreme case where the trustee's counterclaim against the filing creditors involves neither a § 57g issue, recoupment, nor setoff, and is based on a transaction wholly unrelated to the creditor's claim, it has been ruled that the bankruptcy court has no summary jurisdiction to adjudicate the counterclaim if the creditor makes timely objection. *In re Majestic Radio & Television Corp.*, 227 F.2d 152 (7th Cir. 1955), *cert. denied*, 350 U.S. 995 (1956) (creditor filed \$1500 claim for goods sold; trustee pleaded setoff and counterclaim for approximately \$442,000—for breach of fiduciary duty). Although this result may well be proper in some cases—since the complications of *res judicata* and collateral estoppel in a later plenary suit are not involved—the limitation of bankruptcy court jurisdiction over unrelated counterclaims should be made a discretionary matter. This would allow the bankruptcy tribunal to adjudicate the unrelated counterclaim where such action would not prejudice the creditor or cause him undue hardship.

The doctrines of *Alexander v. Hillman* and of complete equity relief strongly support this position; all that is needed to protect the creditor in special circumstances is equity's ameliorating power to remit the trustee to a plenary suit. Moreover, holding that a creditor, by seeking a share in the bankrupt estate, thereby consents to adjudication, not only of his claim, but of all claims the estate may have against him—and this seems to be the teaching of *Hillman*—would not broaden federal jurisdiction. For a party can always consent to summary jurisdiction and, by § 23 of the Bankruptcy Act, to a plenary suit in federal court. Procedurally, there is little difference, other than the presence of a jury, between a summary proceeding and a plenary action; and chances for an early trial are normally better when the case is on the referee's docket.

187. *Heiser v. Woodruff*, 327 U.S. 726 (1946); *Fox v. McGrath*, 152 F.2d 616 (2d Cir. 1945), *cert. denied*, 327 U.S. 806 (1946); *Hyman v. McLendon*, 140 F.2d 76 (4th Cir.), *cert. denied*, 322 U.S. 739 (1944); *Beebe v. O'Reilly*, 124 F.2d 750 (7th Cir. 1941); *Handlan v. Walker*, 200 Fed. 566 (8th Cir. 1912) (judgment awarded to lessor-claimant, who was allowed to sue trustee in state court, determined the amount of the lessor's claim, even though the lessor may not have recovered all the damages to which he was entitled); *In re Mercury Eng'r, Inc.*, 68 F. Supp. 376 (S.D. Cal. 1946) (default judgment

to nonbankruptcy judgments in favor of the bankrupt, no particular problems attend the importation of these basic principles into the bankruptcy field. When, for example, a valid, *pre*-bankruptcy judgment has absolved the bankrupt from liability on a creditor's claim, should the creditor attempt to reassert his claim in bankruptcy, the trustee can plead the former judgment as a bar. Under section 70c, the trustee has the benefit of all defenses available to the bankrupt as against third persons.¹⁸⁹ Similarly, a valid, *pre*-bankruptcy judgment awarding the bankrupt a money judgment or the recovery of some interest in specific property can be enforced in the bankruptcy proceedings. If the bankrupt's interest is nonexempt, it passes under section 70a to the trustee and, unless he abandons the property,¹⁹⁰ he is entitled to enforce the judgment.

The same basic tenets of *res judicata* and full faith and credit govern when a judgment favorable to the bankrupt was rendered *after* bankruptcy. The trustee is entitled to the benefit of a post-bankruptcy *in rem* judgment dealing with nonexempt and nonabandoned property, since there is privity of estate between the bankrupt and the trustee.¹⁹¹ A sufficient relationship or privity between the bankrupt and the trustee also exists to support the trustee's enforcement of a post-bankruptcy *in personam* judgment based upon a nonexempt and nonabandoned chose in action.¹⁹² Certainly, under usual *res judicata* principles, if the trustee intervenes in an action with the consent of the bankruptcy court, he is entitled to the benefit of any subsequently rendered judg-

against bankrupt prior to bankruptcy); *In re Redwine*, 53 F. Supp. 249 (N.D. Ala. 1944); *Lockhart v. Mercer Tube & Mfg. Co.*, 53 F. Supp. 301 (D. Del. 1943) (default judgment against trustee).

Administrative adjudications of a quasi-judicial nature that have not been reversed or otherwise set aside by appropriate proceedings are within the principle. *Arkansas Corp. Comm'n v. Thompson*, 313 U.S. 132 (1941) (valuation of railroad property for tax purposes); *Gardner v. New Jersey*, 329 U.S. 565 (1947) (similar; opinion containing extensive discussion of what matters are open for bankruptcy court consideration); *In re Chicago Rapid Transit Co.*, 192 F.2d 206 (7th Cir. 1951) (denial of workmen's compensation by state agency binding on bankruptcy court); *United States v. Paddock*, 178 F.2d 394 (5th Cir. 1949) (post-bankruptcy renegotiation award by War Contracts Price Adjustment Board to United States is conclusive against trustee).

188. *In re Potts*, 142 F.2d 883 (6th Cir. 1944) (valid state judgment entitled to full faith and credit in bankruptcy but a void judgment has no efficacy).

189. *In re Chicago Rapid Transit Co.*, 192 F.2d 206 (7th Cir. 1951).

190. The trustee—and in a proper case, the receiver before him—has the power to abandon any property which is either worthless, overburdened, or for any other reason certain not to yield benefit to the general estate. 4 COLLIER ¶ 70.42. The abandoned property interest reverts in the bankrupt and he, not the trustee, should be entitled to whatever benefits the judgment accords him. See *Webb v. Raleigh Hardware Co.*, 54 F.2d 1065 (4th Cir. 1932).

191. See note 22 *supra*.

192. *Meyer v. Fleming*, 327 U.S. 161 (1946); 1 COLLIER ¶ 11.10. It has furthermore been stated that "if the suit is continued by the bankrupt, the trustee is concluded by the judgment." *Meyer v. Fleming*, *supra* at 166 n.8.

If the trustee abandons the bankrupt's chose in action, any subsequent judgment favorable to the bankrupt enures to his benefit. *Webb v. Raleigh Hardware Co.*, 54 F.2d 1065 (4th Cir. 1932); 1 COLLIER ¶ 11.10; see note 190 *supra*.

ment, whether in rem or in personam,¹⁹³ just as he is bound by that judgment.¹⁹⁴ In all three cases, however, the nonbankruptcy judgment is res judicata only with respect to the same "cause of action" and does not bar a later suit on a different cause, even though in this suit the parties and their privies may be judicially concluded on certain issues by the doctrine of collateral estoppel.¹⁹⁵

In contrast with situations in which the nonbankruptcy judgment favors the bankrupt, decisions adverse to him rendered by other courts pose vexing problems for the bankruptcy court. Here, the bankruptcy tribunal must determine the extent to which the trustee and those represented by him, such as creditors, should be concluded by the judgment against the bankrupt.¹⁹⁶ The basic issue involves striking a fair balance between the principle of judicial finality and the interests of those who share in the bankrupt estate. Since the creditors are adequately represented by their trustee when he intervenes in an action brought by or against the bankrupt, the courts have uniformly ruled that the judgment, if valid, binds the estate on all matters that were or should have been adjudged.¹⁹⁷ And if the trustee, as representative of the estate, has the right to take over and prosecute an action *begun* by the bankrupt, but fails to do so, the judgment binds not only the parties to the litigation, but the trustee as well.¹⁹⁸ This result is not unfair; since bankruptcy did not abate the suit, the trustee could have replaced the bankrupt and represented the estate. Moreover, the defendant has no choice over whether the suit shall proceed under either the original plaintiff's or the trustee's aegis, and a final judgment on the merits should conclude the matter among the parties and the trustee.

Situations in which the trustee has not intervened or had the option of continuing an action begun by the bankrupt naturally require that different factors be considered. Often, distinctions must be made between pre- and post-bankruptcy judgments and between in rem and in personam actions. Especially in the case of a pre-bankruptcy judgment, considering whether judgment followed vigorous litigation by the debtor may at times be proper. While a judgment wholly or partially adverse to the bankrupt may terminate

193. *In re Skinner*, 97 Fed. 190 (N.D. Iowa 1899).

194. *Heiser v. Woodruff*, 327 U.S. 726 (1946); *Fischer v. Pauline Oil & Gas Co.*, 309 U.S. 294 (1940), 53 HARV. L. REV. 1043; *Davis v. Friedlander*, 104 U.S. 570 (1881); *In re American Fid. Corp.*, 28 F. Supp. 462 (S.D. Cal. 1939).

195. See *Burke v. Munger*, 138 Neb. 74, 292 N.W. 53 (1940). In *Burke*, the bankruptcy trustee intervened in a proceeding for the foreclosure of certain mortgages which the bankrupt corporation had assigned as collateral security for a loan, in order to recover the excess over the amount of the loan. The Nebraska court held that neither this action by the trustee nor the foreclosure judgment estopped his bringing action against the bank to recover the amount of a loan made by it to the corporation, which a corporate officer, with the bank's knowledge, had applied to reduce his individual indebtedness to the bank.

196. If a corporation is in reorganization and is solvent, the trustee also represents all classes of shareholders having an equity in the corporation.

197. See cases cited note 194 *supra*.

198. See *Meyer v. Fleming*, 327 U.S. 161 (1946); *Paradise v. Vogtlandische Maschinen-Fabrik*, 99 F.2d 53 (3d Cir. 1938).

an action begun by the debtor,¹⁹⁹ more often than not the adverse judgment stems from a suit brought against the debtor. In this suit, the debtor may have actively asserted his claim or defense. The adverse judgment, however, may have been one by consent, confession or default, entered after little or no litigation on the debtor's part. Thus, the general proposition that a pre-bankruptcy judgment which would adversely bind the bankrupt²⁰⁰ likewise concludes the trustee²⁰¹ is subject to important exceptions.

Significant here are judicial expressions to the effect that the Bankruptcy Act is paramount law;²⁰² that fraud may vitiate the judgment as against the bankrupt estate;²⁰³ and that the trustee, as representative of creditors, is armed with extensive powers to avoid, under certain circumstances, judicial liens, preferences, and fraudulent or otherwise proscribed transfers.²⁰⁴ Relative to the paramountcy of the Bankruptcy Act, *Kalb v. Feuerstein*²⁰⁵ and related cases have held that when bankruptcy operates as an automatic statutory stay, further proceedings in an in rem suit, absent bankruptcy court approval, are null and void, even though a decree is entered in the in rem action.²⁰⁶ Stressing the trustee's powers, courts have determined that a pre-bankruptcy judgment in rem, though forever terminating the bankrupt's rights to the res, does not adjudge the rights of the trustee under the avoiding sections of the Bankruptcy Act.²⁰⁷ Accordingly, a pre-bankruptcy decree of foreclosure against the bank-

199. See, e.g., *Hyman v. McLendon*, 140 F.2d 76 (4th Cir.), *cert. denied*, 322 U.S. 739 (1941).

200. To the extent that the bankrupt could defend against the enforcement of the judgment, the trustee succeeds to his defense under § 70c. Thus, a judgment subject to collateral attack or to voidability by the bankrupt—for example, because it was fraudulently obtained—would be nonenforceable against the trustee. Cf. *Pepper v. Litton*, 308 U.S. 295 (1939) (holding that the trustee may prevent enforcement of a fraudulently-obtained judgment against the estate even when the judgment binds the bankrupt); *In re Rubin*, 24 F.2d 289 (7th Cir. 1928). Normally, however, a judgment rendered by a court of authority is not subject to collateral attack; and hence a pre-bankruptcy judgment against the bankrupt would not ordinarily be subject to collateral attack by the trustee.

201. *Heiser v. Woodruff*, 327 U.S. 726 (1946); *In re Redwine*, 53 F. Supp. 249 (N.D. Ala. 1944).

The trustee is bound, generally, even though the judgment against the bankrupt was a consent judgment, stipulated judgment, judgment by confession, or default judgment. *Hyman v. McLendon*, 140 F.2d 76 (4th Cir.), *cert. denied*, 322 U.S. 739 (1944) (consent or stipulated judgment); *Fox v. McGrath*, 152 F.2d 616 (2d Cir. 1945), *cert. denied*, 327 U.S. 806 (1946) (stipulated judgment); *In re Mercury Eng'r, Inc.*, 68 F. Supp. 376 (S.D. Cal. 1946) (default judgment).

202. See text accompanying notes 48-52 *supra*.

203. *Pepper v. Litton*, 308 U.S. 295 (1939).

204. See notes 27-30 *supra* and accompanying text.

205. 308 U.S. 433 (1940), 28 GEO. L.J. 1129, 24 MINN. L. REV. 981, 1940 WIS. L. REV. 424. See also *In re Potts*, 142 F.2d 883 (6th Cir. 1944) (ch. XII proceeding).

206. As to whether the precise holding of *Kalb* would preclude a nonbankruptcy court from determining its own authority to proceed if the issue were litigated in that court by the bankrupt or his representative, see note 50 *supra*.

207. *Berrara v. City Real Estate Co.*, 64 F.2d 498 (2d Cir. 1933).

rupt does not prevent the trustee from attacking a mortgage as fraudulent or preferential and, if the mortgage is found invalid as against the trustee under the Bankruptcy Act, from an appropriate recovery of the property or its proceeds from one not a bona fide purchaser for value.²⁰⁸

The effect of fraud upon the recognition in bankruptcy of an adverse pre-bankruptcy judgment is outlined in the two leading cases of *Pepper v. Litton*²⁰⁹ and *Heiser v. Woodruff*.²¹⁰ In the former, Litton, a controlling stockholder, obtained judgment by confession in a state court against his wholly-owned corporation. He had alleged salary claims dating back over five years. Subsequently, the corporation became bankrupt. Under the authorization of the bankruptcy tribunal, the trustee, moving in the state court to set aside the judgment and to quash its execution, asserted that it was void since it had not been confessed in the manner required by local law. Although agreeing that the Litton judgment was void, the state court denied the trustee's motion on the theory that Pepper, a general creditor, treated the fund derived from the execution sale as valid in an interpleader suit and consequently had elected to recognize the validity of the judgment; that, apart from Litton, Pepper was then the only general creditor; and that, since Pepper was estopped, so was the trustee. Thereafter, the question of honoring Litton's judgment as a preferred claim to the extent that it was secured by lien and as a common claim with regard to the deficiency came before the bankruptcy court on exceptions made by Pepper. The bankruptcy court held that the state tribunal's decision that the trustee was estopped to attack the Litton judgment did not prevent bankruptcy reconsideration of the judgment's validity. Having reviewed the facts, the bankruptcy court concluded that Litton and his "one-man" corporation had deliberately planned to avoid the payment of a just debt to Pepper, and that both the judgment by confession and the steps taken by Litton to enforce that judgment had been part of the fraudulent scheme. It disallowed the Litton claim entirely and directed the trustee to recover for the estate the corporate property which Litton had purchased at the execution sale following his judgment. Holding that the state court judgment was res judicata in the bankruptcy proceedings, the court of appeals reversed; but the Supreme Court affirmed the bankruptcy court's judgment. Justice Douglas, writing for the Court, reasoned that the Virginia state court's refusal to set aside Litton's judgment by confession for irregularity did not involve the same issues raised in the bankruptcy court—the validity of Litton's underlying claim and the priority it deserved in the bankruptcy distribution. Nor were these issues open

208. *Ibid.* (foreclosure suit had not gone to decree, but this fact is immaterial under the court's reasoning); see *Jasper v. Rozinski*, 228 N.Y. 349, 127 N.E. 189 (1920) (foreclosure judgment held not to be res judicata in a judgment creditor's suit to have the mortgage adjudged fraudulent as to him and to reach and apply the proceeds of the sale as against the fraudulent transferee).

209. 308 U.S. 295 (1939), discussed in Note, *Classification of Claims in Debtor Proceedings*, 49 YALE L.J. 881 (1940).

210. 327 U.S. 726 (1946), 22 IND. L.J. 77, 32 VA. L. REV. 643.

for adjudication in the state court. Since, under accepted orthodoxy, a judgment is *res judicata* only of matters actually adjudged or that should have been adjudged,²¹¹ and since what should have been adjudged necessarily excludes issues which cannot be raised under forum procedures governing the particular litigation,²¹² the Court concluded that the trustee was free to oppose Litton in the bankruptcy hearing.²¹³

The *res judicata* consequences of the state court judgment properly restricted to what had been decided, the effect to be given to Litton's confessed judgment in the distribution of his solely-owned corporation's assets was relatively easy of solution. The machinations of Litton and his dummy corporation were

211. See note 8 *supra* and accompanying text.

212. *In re James A. Brady Foundry Co.*, 3 F.2d 437 (7th Cir. 1924).

213. 308 U.S. at 302-03 (Douglas, J.):

In the first place, *res judicata* did not prevent the District Court from examining into the Litton judgment and disallowing or subordinating it as a claim. When that claim was attacked in the bankruptcy court Litton did not show that the proceeding in the state court was anything more than a proceeding under Virginia practice to set aside the judgment in his favor on the ground that it was irregular or void upon its face. He failed to show that the judgment in the state court was conclusive in his favor on the validity or priority of the underlying claim, as respects the other creditors of the bankrupt corporation—a duty which was incumbent on him. On the pleadings in the state court the validity of the underlying claim was not in issue. Nor was there presented to the state court the question of whether or not the Litton judgment might be subordinated to the claims of other creditors upon equitable principles. The motion on which that proceeding was based challenged the Litton judgment on one ground only, viz., that it was void *ab initio* because it was not confessed by Dixie Splint Coal Company [the now bankrupt corporation] in the manner required by the Virginia statute and because P. H. Smith [the corporation's secretary and treasurer] did not have either an implied or express power to confess it. In other words, in the state court under the pleadings and practice, the only decree which was asked or could be given in the plaintiff's favor was for cancellation of the judgment as a record obligation of the bankrupt. It is therefore plain that the issue which the bankruptcy court later considered was not an issue in the trial of the cause in the state court and could not be adjudicated there.⁹ Hence, the failure on the part of Litton to establish that the state judgment was *res judicata* plus his submission of his judgment to the bankruptcy court for allowance (as a preferred claim to the extent that it was secured by the alleged lien and as a common claim as respects the deficiency) plainly left the bankruptcy court with full authority to follow the course it took and to determine the validity of Litton's alleged secured claim and the priority which should be accorded it in the distribution of the bankrupt estate. In the second place, even though we assume that the alleged salary claim on which the Litton judgment was based was not fictitious but actually existed, we are of the opinion that the District Court properly disallowed or subordinated it.

The Court's footnote 6 added:

It should be noted that there is authority for the conclusion that the trustee is not necessarily precluded from questioning a judgment in the bankruptcy proceedings merely because he attacked it in a state court proceeding, where the state court did not pass upon the validity of the underlying claim. *In re James A. Brady Foundry Co.*, 3 F.2d 437; Gilbert's *Collier on Bankruptcy* (4th ed.) § 1247.

egregiously fraudulent. Further, in his owner's position as fiduciary for corporate creditors, he was precluded from proving his claim in competition with them or gaining from the estate any personal advantage, security or priority over them. In these circumstances, the bankruptcy court, applying the principles and rules of equity jurisprudence, had ample powers to disallow or subordinate Litton's judgment claim ²¹⁴ without re-examining the merits of the judgment itself.²¹⁵

Although *Heiser v. Woodruff* also involved an issue of fraud, its similarity to *Pepper* ends there. Heiser sued Woodruff, alleging that the defendant had by false pretenses obtained valuable raw stones from him and had subsequently converted them. His suit, brought in a federal district court in California on the basis of diversity, ended in a default judgment for more than a quarter-million dollars. Shortly thereafter, Woodruff moved to have the judgment set aside on the ground, *inter alia*, that the minerals were worthless and that Heiser had procured the favorable decision through perjured allegations in the complaint and false testimony of value. After a fully contested hearing ordered by the district court to determine the value of the converted gems, the court rendered a decree stating the value of the gems to be as alleged in the complaint and declining to set aside the judgment. Woodruff neither appealed the default judgment nor the denial of his motion to set aside the judgment.

If judicial finality has any meaning at all, it would seem that Heiser's judg-

214. Cf. *American Sur. Co. v. Sampsell*, 327 U.S. 269 (1946) (surety may not compete in bankruptcy with the assured creditor); *Sampsell v. Imperial Paper & Color Corp.*, 313 U.S. 215 (1941) (unsecured creditor of Downey's family corporation held entitled only to *pari passu* participation with the bankrupt Downey's individual creditors, the trustee having avoided a fraudulent transfer of assets by Downey to his corporation); *Taylor v. Standard Gas & Elec. Co.*, 306 U.S. 307 (1939) (parent corporation's claim, as creditor, against its subsidiary, which was in reorganization, held subordinate to the interests of the subsidiary's preferred stockholders on a showing that, through its majority ownership and interlocking directors, the parent had mismanaged the subsidiary for its own benefit); see Bayne, *The Deep Rock Doctrine Reconsidered*, 19 *FORDHAM L. REV.* 43, 152 (1950) (discussing the *Taylor* case); Note, 47 *COLUM. L. REV.* 800 (1947); Comment, 29 *TEXAS L. REV.* 71 (1950). See also Gleick, *The Equitable Power of Bankruptcy Courts To Subordinate Claims or To Disallow Claims Entirely on Equitable Grounds*, 25 *REF. J.* 99 (1951); Note, *Classification of Claims in Debtor Proceedings*, 49 *YALE L.J.* 881 (1940). Compare *Prudence Realization Corp. v. Geist*, 316 U.S. 89 (1942), with *Prudence Realization Corp. v. Ferris*, 323 U.S. 650 (1945).

Since Litton was the owner of his bankrupt corporation, it made little, if any, difference for bankruptcy purposes whether his claim against his corporation was subordinated to other creditors or disallowed. Yet, because of the *res judicata* effect in another proceeding, of an order allowing or disallowing a claim, see notes 164-66 *supra*, it is ordinarily desirable to define the scope of the order in its very context. If the claim has merit but should be postponed in distribution to other claims, probably the best solution is to allow the claim and postpone distributive participation in accordance with attendant circumstances. 3 *COLLIER* ¶ 57.14.

215. As subsequently interpreted in the *Heiser* case, *Pepper v. Litton* did not involve a re-examination of the claim underlying Litton's judgment by confession. See text accompanying note 221 *infra*.

ment was *res judicata* on the issues of the conversion by Woodruff and the value of the converted property, and that the district court's finding forever concluded Woodruff and his privies. Nevertheless, the courts experienced considerable difficulty. Shortly after the California proceedings, Woodruff became a voluntary bankrupt in an Oklahoma federal court. Heiser, acting under section 63a(1) of the Bankruptcy Act, which provides that a fixed liability evidenced by a judgment is a provable claim in bankruptcy, filed a proof of claim based on the federal judgment obtained in California. Certain creditors and the bankrupt objected to allowance and, upon authorization by the referee, the trustee and the bankrupt filed a joint motion in the federal district court of California for relief from the Heiser judgment. Again, the same charge of fraud—the fictitious value of the gems—was made and the allegation denied by Heiser. The trustee and the bankrupt offered no proof in support of their motion, and it was denied by the district court. The Ninth Circuit affirmed.²¹⁶

The scene of battle then shifted to the bankruptcy court in Oklahoma, where the referee heard evidence and completely disallowed Heiser's claim. On review, the district court reinstated the claim in full, holding that the California proceedings were *res judicata*. The Tenth Circuit reversed.²¹⁷ In rejecting Heiser's contention of *res judicata* and directing inquiry into the merits of the original cause of action—including the allegation of fraudulent procurement—the court of appeals rested its decision on the trustee's failure to proffer proof of fraud in the California district court. Relying on *Pepper v. Litton*, it held that the bankruptcy court's equity powers were not foreclosed by *res judicata* on issues not pressed before the California district court and that the authority of a bankruptcy court as a court of equity includes the power to inquire into the merits of any claim upon which a judgment presented as a claim against the estate is based.

The Supreme Court reversed the Tenth Circuit and affirmed the district court. Chief Justice Stone agreed that, under *Pepper v. Litton*, a bankruptcy court "may exercise equity powers in bankruptcy proceedings to set aside fraudulent claims, including a fraudulent judgment where the issue of fraud has not been previously adjudicated."²¹⁸ He felt, moreover, that in appropriate cases the bankruptcy tribunal could "subordinate the claim of one creditor to those of others in order to prevent the consummation of a course of conduct by the claimant which, as to them, would be fraudulent or otherwise inequitable."²¹⁹ But he could find no basis—not even in *Pepper*—for "the rejection by a federal court of the salutary principle of *res judicata*, which is founded upon the generally recognized public policy

216. *Jackson v. Heiser*, 111 F.2d 310 (9th Cir. 1940).

217. 150 F.2d 869 (10th Cir. 1945).

218. 327 U.S. at 732.

219. *Ibid.* The Chief Justice also affirmed that, in allowing, disallowing or subordinating a claim—including a claim based on a judgment—"the bankruptcy court is defining and applying federal, not state, law" and the principle of *Erie v. Tompkins* is inapplicable. *Id.* on 733.

that there must be some end to litigation and that when one appears in court to present his case, is fully heard, and the contested issue is decided against him, he may not later renew the litigation in another court":²²⁰

Pepper v. Litton . . . lends no support to a different view. Undoubtedly, since the Bankruptcy Act authorizes a proof of claim based on a judgment, such a proof may be assailed in the bankruptcy court on the ground that the purported judgment is not a judgment because of want of jurisdiction of the court which rendered it over the persons of the parties or the subject matter of the suit, or because it was procured by fraud of a party. . . . But it is quite another matter to say that the bankruptcy court may reexamine the issues determined by the judgment itself. . . . Nor can an attack be sustained on a judgment allegedly procured by fraudulent representations of the plaintiff, when the charge of fraud has been rejected in previous litigations by the parties to the suit in which the judgment was rendered, or their representatives. . . .²²¹

Finally, the Chief Justice found no equitable principle warranting subordination:

[When Heiser] brought his suit for conversion he was not a fiduciary for the defendant, Woodruff, or his creditors. There was no equitable ground upon which his claim or the judgment upon it could be set aside or subordinated to those of other creditors in the bankruptcy proceeding, except that asserted by respondents that the judgment had been procured by a fraud perpetrated on the judgment debtor. That issue, having been twice litigated and decided in the court in which the judgment was rendered, in proceedings brought by the trustee in bankruptcy and the bankrupt, and by the bankrupt alone, may not be relitigated in the bankruptcy court.²²²

Would the result have been different if the trustee in *Heiser* had not proffered the issue of fraud in the California district court? Certainly this situation would not afford as strong a case for application of res judicata. Yet, under these facts a judgment would probably be deemed conclusive, both on the merits of the creditor's claim and the allegation of fraud, since the debtor would have fairly litigated the fraud issue central to the validity of the claim.²²³

By contrast, if it is assumed that the issue of fraud has not been litigated by either the bankrupt or the trustee, the only way to preclude the trustee from utilizing fraud as a defense when the creditor claims on his judgment is to say that, since the issue of fraud was open to the bankrupt in the first action he is thereafter foreclosed and, with him, his subsequent trustee. But this would work undue hardship on creditors. To the extent that the rules of the forum rendering the judgment permit the bankrupt to seek relief by appeal or by petitioning the trial court for redress, the trustee has a permissive right to

220. *Id.* at 733.

221. *Id.* at 736.

222. *Id.* at 739-40.

223. See the Court's language in text accompanying note 221 *supra*.

follow that course of action.²²⁴ And if the fraud or other action of the creditor is of such a character that the bankrupt would be entitled to have the creditor enjoined from enforcing his judgment, then the trustee, succeeding to the bankrupt's rights, could prevent the creditor's inequitable participation in the bankrupt estate.²²⁵ In the interest of creditors, moreover, the trustee should also exercise his power to seek the disallowance or subordination of a judgment claim, though the judgment be binding on the bankrupt, when its enforcement would run counter to sound principles of bankruptcy distribution among creditors. This procedure would not violate the doctrine that an issue which has been fairly adjudged is closed to relitigation, since there is incomplete privity between the bankrupt and the trustee. The latter not only takes the bankrupt's estate but also represents creditors; thus, a judgment, though binding upon the bankrupt, is not always conclusive upon the creditors or their trustee.²²⁶

Aside from the conclusory effect of a pre-bankruptcy judgment in establishing certain issues, such a judgment, if for the recovery of money, has an independent bearing upon the provability of a claim in bankruptcy (although not in reorganization and arrangement proceedings).²²⁷ Section 63a provides that "debts of the bankrupt may be proved and allowed against his estate which

224. See Bankruptcy Act §§ 11b-c, 30 Stat. 549 (1898), 11 U.S.C. §§ 29b-c (1952).

This procedure was followed in both the *Pepper v. Litton* and *Heiser v. Woodruff* cases. See also *In re James A. Brady Foundry Co.*, 3 F.2d 437 (7th Cir. 1924). Once adopting this action, the trustee is bound on all relevant issues that were or could have been adjudged, *Heiser v. Woodruff*, 327 U.S. 726 (1946); but the judgment is not res judicata of matters that were not open for adjudication, *Pepper v. Litton*, 308 U.S. 295 (1939); *In re James A. Brady Foundry Co.*, *supra*. See also note 212 *supra*.

225. See note 200 *supra*.

226. *In re Continental Engine Co.*, 234 Fed. 58, 60 (7th Cir. 1916) ("The reduction of an alleged debt to judgment in a state court before bankruptcy does not exempt it from attack by or on behalf of creditors who would be injuriously affected by its allowance, when such allowance is sought in bankruptcy proceedings."). The *Continental* case is cited with approval in *Heiser*. 327 U.S. at 736. For further discussion of this case, regarding the effect of adjudication in establishing a petitioning creditor's claim, see note 146 *supra* and accompanying text.

227. In reorganization and arrangement proceedings, in keeping with their rehabilitation purposes, claims of every character against the bankrupt, except stock, are provable. Bankruptcy Act § 77(b) (Railroad Reorganization), 47 Stat. 144 (1933), as amended, 11 U.S.C. § 205(b) (1952); § 82 (Municipal Debt Readjustment), 50 Stat. 654 (1938), as amended, 11 U.S.C. § 402 (1952); § 106(1), 52 Stat. 883 (1938), 11 U.S.C. § 506(1) (1952); § 307 (Arrangements), 52 Stat. 906 (1938), as amended, 11 U.S.C. § 707 (1952); § 406(2) (Real Property Arrangements), 52 Stat. 916 (1938), as amended, 11 U.S.C. § 806(2) (1952); § 606(1) (Wage Earners' Plans), 52 Stat. 930 (1938), as amended, 11 U.S.C. § 1006(1) (1952) (also excluding "claims secured by estates in real property or chattels real"). The scope of § 63, which governs the provability of claims in bankruptcy, is less comprehensive. For example, with the one exception of § 63a(7)—"the right to recover damages in any action for negligence instituted prior to and pending" at bankruptcy—a "pure" tort claim is not provable in bankruptcy. See notes 159-63 *supra* and accompanying text. For the general reasons underlying nonprovability of tort claims, see *In re Shawsheen Dairy*, 47 F. Supp. 494 (D. Mass. 1942).

are founded upon (1) a fixed liability, as evidenced by a judgment . . . absolutely owing" at the time of bankruptcy. The Supreme Court has reasoned that this "language is broad and unqualified" and "includes 'a fixed liability' evidenced by a judgment *ex delicto* as well as by a judgment *ex contractu*, and that it makes the one as well as the other a provable 'debt.'"²²⁸ Hence, a pre-bankruptcy money judgment is normally provable whether the underlying claim is provable or, like the "pure" tort claim, is nonprovable.²²⁹ Still, to carry out the purpose of the Bankruptcy Act, the court will look to the nature of the claim underlying the judgment in appropriate cases.²³⁰

A judgment is "absolutely owing," within the meaning of section 63a(1), upon its effective rendition.²³¹ If rendition does not occur prior to bankruptcy, the judgment is not provable under clause (1).²³² But when judgment precedes bankruptcy, the judgment claim is provable irrespective of the pendency of an appeal, although the appeal may cause the distribution of a dividend on the litigated claim to be postponed.²³³

Res judicata problems also involve the provability as claims in bankruptcy of post-bankruptcy judgments rendered against the debtor. Here, a distinction must be drawn between in personam and in rem judgments. With respect to the former, clause (5) of section 63 authorizes recognition of

. . . provable debts reduced to judgments after the filing of the petition and before the consideration of the bankrupt's application for a discharge, less costs incurred and interest accrued after the filing of the petition and up to the time of the entry of such judgments.

228. *Lewis v. Roberts*, 267 U.S. 467, 469 (1925).

229. *Ibid.*

230. Pre-bankruptcy judgments for alimony are still held nonprovable. Prior to 1903, when § 17 was amended to except from discharge liabilities for alimony due or to become due, and for maintenance or support of a wife or child, the Supreme Court, with a view to avoiding the husband's or father's release through discharge in bankruptcy, held that the marital or parental duty to support wife and children was not a "debt" and hence not provable, even when evidenced by a decree or judgment, and irrespective of the judgment's immutability. *Audubon v. Shufeldt*, 181 U.S. 575 (1901). The Court adhered to this position after the 1903 amendment to § 17 had eliminated the previous reason for holding alimony and related claims nonprovable. *Wetmore v. Markoe*, 196 U.S. 68 (1904) (the claims in this case, however, antedated the 1903 amendment). And so the concept of alimony as a "penalty" lingers on. But see *Heimberger v. Joseph*, 55 F.2d 171 (6th Cir. 1931). For general discussion, see 1 COLLIER ¶¶ 17.18-19; 3 *id.* ¶ 63.13.

Section 63a(1), moreover, must be read in conjunction with § 57; hence a judgment on a governmental claim for a penalty or forfeiture is neither provable nor allowable, except as regards that portion of the judgment representing the pecuniary loss attending the act, transaction or proceeding from which the governmental penalty or forfeiture arose. *In re Abramson*, 210 Fed. 878 (2d Cir. 1914); see 3 COLLIER ¶¶ 57.22, 63.12.

231. *In re Ganet Realty Corp.*, 83 F.2d 945 (2d Cir. 1936).

232. *Royal Baking Powder Co. v. Hessey*, 76 F.2d 645 (4th Cir.), *cert. denied*, 296 U.S. 595 (1935) (*nunc pro tunc* rendition held ineffective). But the judgment may be provable under § 63a(5).

233. *Grafton v. Lloyd*, 86 F.2d 205 (9th Cir. 1936); *Moore v. Douglas*, 230 Fed. 399 (9th Cir. 1916) (holding the claim provable even though the California state court judgment has no res judicata effect during the pendency of an appeal).

Unlike clause (1), which deals with pre-bankruptcy judgments, clause (5) requires the claim underlying the post-bankruptcy judgment to be provable in its own right. The post-bankruptcy judgment does not, therefore, enlarge the categories of claims that are provable.²³⁴ Since, for example, a "pure" tort claim is generally nonprovable, a post-bankruptcy judgment on such a claim cannot be proved.²³⁵ Thus, a creditor's proof of claim under section 63a(5) is based on *both* the original claim *and* the judgment. The creditor invokes the original claim for the purpose of demonstrating the judgment to be based on a debt itself provable; he offers the judgment to avoid a retrial on the merits.

Under what circumstances is the judgment conclusive and a retrial on the merits avoided? Section 57d places the liquidation of unliquidated claims under the supervision of the bankruptcy court.²³⁶ This general provision yields to other congressional legislation placing exclusive jurisdiction to liquidate particular types of claims in other courts or agencies.²³⁷ Subject to this qualification, however, it is reasonably held that sections 63a(5) and 57d must be read together, and that liquidation of a claim not reduced to judgment prior to bankruptcy is subject to bankruptcy court supervision. The court may of course order the trustee to appear and defend the pending suit. A judgment entered by the outside court will then bind the estate. But if the bankruptcy court does not direct this method of liquidation, a post-bankruptcy judgment should not be held conclusive in the bankruptcy proceedings.²³⁸

234. 3 COLLIER ¶ 63.27.

235. On the other hand, a contract claim is provable, Bankruptcy Act § 63a(4), 30 Stat. 562 (1898), as amended, 11 U.S.C. § 103a(4) (1952), as is a tort claim for negligence where the action is pending at the time of bankruptcy, see notes 159-63 *supra*. See also 3 COLLIER ¶ 63.27.

236. See *id.* ¶ 57.15.

237. *United States v. Paddock*, 178 F.2d 394 (5th Cir. 1949) (War Contracts Price Adjustment Board's post-bankruptcy award in favor of the United States and against a contractor, made in proceedings pending before the contractor's bankruptcy, is conclusive upon the trustee); *cf.* *Cullen v. Bowles*, 148 F.2d 621 (2d Cir. 1945); *In re Spier Aircraft Corp.*, 137 F.2d 736 (3d Cir. 1943), *cert. denied*, 321 U.S. 770 (1944).

238. Considerable authority supports this view, particularly where the judgment was entered after the adjudication in bankruptcy. *In re Paramount Publix Corp.*, 85 F.2d 42 (2d Cir. 1936); *In re James A. Brady Foundry Co.*, 3 F.2d 437 (7th Cir. 1924); *In re Barrett & Co.*, 27 F.2d 159 (S.D. Ga.), *aff'd sub nom. Rhodes v. Elliston*, 29 F.2d 737 (5th Cir. 1928); *In re Tietenberg*, 15 Am. Bankr. R. (n.s.) 580 (W.D.N.Y. 1913) (post-bankruptcy deficiency decree); see *Doyle v. Nemerov's Ex'rs*, 223 F.2d 54 (2d Cir. 1955), 69 HARV. L. REV. 754 (1956); 1 COLLIER ¶ 11.09, at 1170-73; 3 *id.* ¶ 57.15, at 205-09; *id.* ¶ 63.27. Some courts, however, discounting or ignoring § 57d, have relied on the proposition that bankruptcy does not abate a pending suit and that § 63a(5) makes provable a post-bankruptcy judgment coming within its terms. See *United States v. Paddock*, 178 F.2d 394 (5th Cir. 1949); *In re Anton*, 11 F. Supp. 345 (D. Minn. 1935); *In re Buchan's Soap Corp.*, 169 Fed. 1017 (S.D.N.Y. 1909); 1 COLLIER ¶ 11.09, at 1170-73. Analogizing approval of a corporate reorganization proceeding to an adjudication in bankruptcy, the Second Circuit has held that an in personam post-bankruptcy judgment rendered in the time between the filing of the petition and its approval is *res judicata* in the reorganization proceeding. *Doyle v. Nemerov's Ex'rs*, *supra*; *cf. In re Paramount Publix Corp.*, *supra*.

Somewhat different principles are involved whenever the post-bankruptcy judgment is in rem. If an in rem suit commenced prior to bankruptcy or reorganization is not stayed,²³⁹ the in rem judgment binds the bankrupt's or debtor's estate whether or not the trustee has become a party to the action. To this extent, the trustee is treated as any other person succeeding to an interest in property pending litigation.²⁴⁰ But the judgment does not preclude the trustee from suing either the plaintiff of the in rem suit or some other appropriate person to recover property pursuant to the avoiding sections of the Bankruptcy Act dealing with preferential, fraudulent and other voidable transfers.²⁴¹ Moreover, under the better view, an in personam deficiency decree rendered after bankruptcy in the in rem suit does not bind the trustee unless he became a party to the action.²⁴²

After bankruptcy, an in rem action may not properly be commenced, if it deals with property over which the bankruptcy court has acquired jurisdiction, without leave of the bankruptcy court.²⁴³ The court can therefore protect the estate against prejudicial post-bankruptcy in rem suits. An in rem action concerning property over which the bankruptcy court has not acquired jurisdiction, however, may be brought, and the trustee joined as defendant, without bankruptcy court permission; and any judgment in that action, including a default judgment, binds the trustee.²⁴⁴

CONCLUSION

The Bankruptcy Act is a paramount law enacted by Congress to provide both relief for the distressed debtor and an equitable liquidation or rehabilitation of his estate for the benefit of creditors and, in some instances, stockholders. Res judicata and collateral estoppel, on the other hand, are judicially evolved principles opposing unwarranted litigation by according conclusory effect to matters adjudged. Due process concepts and the rule of full faith and credit shape the application of these principles of judicial finality.

In a direct conflict between the Bankruptcy Act and judicial finality, the act would probably triumph, for the broad headings "res judicata" and "collateral estoppel" denominate congeries of rules, most of which are subject to both statutory and judicial modification. There need be no such conflict, however, for the rules of res judicata and collateral estoppel can be applied in bankruptcy in conformity with the objectives of both bankruptcy and judicial finality.

239. For stay provisions, see note 21 *supra* and accompanying text.

240. See note 22 *supra* and accompanying text.

241. See note 208 *supra* and accompanying text.

242. *In re Kenwood Storage & Warehouse Corp.*, 4 F. Supp. 561 (E.D.N.Y. 1930); *In re Tietenberg*, 15 Am. Bankr. R. (n.s.) 580 (W.D.N.Y. 1930); see *In re Soltmann*, 249 Fed. 455 (2d Cir. 1918); note 238 *supra* and accompanying text.

243. *Isaacs v. Hobbs Tie & Timber Co.*, 282 U.S. 734 (1931). See also note 21 *supra*.

244. *Lockhart v. Mercer Tube & Mfg. Co.*, 53 F. Supp. 301 (D. Del. 1943).

Indeed, bankruptcy has not only extended a welcome to judicial finality—it has made distinct contributions to the principle. A federal district court administers the Bankruptcy Act. As in the exercise of its more general law and equity jurisdiction, the district court sits as a court of authority. And like other courts of authority, its judgments are normally immune to collateral attack. Two leading cases that narrowly restrict the doctrine of collateral attack while sustaining the general validity of judgments—*Stoll* and *Chicot County*—have dealt with bankruptcy adjudications.

As with judgments of other forums, when the effect of a bankruptcy court's decree is in dispute, a determination of whether the decree is in rem or in personam is necessary, and, if in rem, of whether it has any in personam effect. A turnover order, like a mandatory injunction, is in personam. Decrees of adjudication and discharge, on the other hand, which determine status, are in rem, and generally have no in personam consequences. If, however, the bankruptcy court has in personam jurisdiction over a particular person, the in rem decree will be given in personam effect as to that person.

Both the denial and grant of a discharge raise problems peculiar to bankruptcy. Denial is generally *res judicata* that the claims listed in that proceeding are nondischargeable. The decree affirming discharge, while establishing the status of the bankrupt, does not generally determine its effect upon claims. Since the consequences of discharge decrees are normally tested in nonbankruptcy proceedings, abuses can arise when overreaching creditors are pitted against destitute and ill-informed bankrupts. A wise and wider use of the bankruptcy court's ancillary jurisdiction to effectuate its decrees can prevent, or at least minimize, these abuses.

Relative to claims by creditors, secured and unsecured, the special *res judicata* problems most troublesome are two. The first involves the claim of a creditor who has or may have received a transfer voidable under the act. It will be remembered that section 57g makes such receipt a defense to the allowance of his claim. Failure to present this defense has no *res judicata* effect, and accordingly does not preclude the trustee from instituting independent action to avoid the transfer. When, however, the trustee does oppose the creditor's claim on the basis of section 57g, the principle of collateral estoppel becomes enmeshed with that of summary jurisdiction. Here, courts have taken divergent positions—illustrated by the opinions in *Inter-State Nat'l Bank v. Luther*—regarding the resolution of the defense and the bankruptcy court's jurisdiction to render an affirmative judgment for recovery of the avoided transfer.

The second problem involves claims based on either pre- or post-bankruptcy judgments. Of these, the claim on a pre-bankruptcy judgment is more common and better illustrates the interrelation of judicial finality and bankruptcy law. Summarizing discussion is therefore confined to this type of judgment.

Section 63a(1) authorizes the proof and allowance of a claim based on a judgment. A fair inference is that the judgment is ordinarily record evidence of matters adjudged, and the bankruptcy court should not re-examine the

merits. Of course, in those situations in which a judgment is subject to collateral attack as void, proof of claim based on the judgment may be assailed on the ground that the judgment lacks legal effect. But this will not occur frequently, for the area of permissible collateral attack is sharply restricted.

In passing upon claims, including those based on pre-bankruptcy judgments, the bankruptcy court applies federal law and seeks to implement federal policies. The doctrine of *res judicata* is thus subject to the paramount equitable powers of bankruptcy courts to prevent the perpetration of fraud and collusion by disallowing or subordinating a judgment claim. And privity between the bankrupt and the trustee is not so complete that a judgment binding the bankrupt will always conclude the creditors or their representative, the trustee. Still, when fraud, or another issue interposed in defense to the judgment claim, has already been fairly adjudged—whether inside or outside the bankruptcy court—principles of *res judicata* preclude its re-adjudication, and the bankruptcy court, in the exercise of its equitable powers, must respect and apply those principles.

The unifying ideas, then, that appear throughout the bankruptcy treatment of *res judicata* and collateral estoppel are simply these. Judicial finality prevents an encore and gives repose both to litigants and society. Not self-executing, like any other salutary rule, it must be applied with its true objective in mind—the prevention of needless, repetitious litigation. Litigation is neither needless nor repetitious unless those to be bound by, or to benefit from, a prior judgment have had their day in court—a fair opportunity to litigate the issues upon which they are to be concluded. A realistic appraisal of this question is important in ordinary civil suits between ordinary litigants. It is particularly important in bankruptcy, where litigation affecting many persons with diverse interests is commonplace.